

OFFICE OF GENERAL COUNSEL

October 10, 2000

TO ALL PARTIES OF RECORD

Gas Utilities Docket Nos. 9145-9147; 9148

Appeal of TXU Gas Distribution from the action of the City of Dallas, City of University Park, and the Town of Highland Park, Texas and Statement of Intent filed by TXU Gas Distribution to increase rates charged in the environs of the City of Dallas, City of University Park, City of Cockrell Hill, and the Town of Highland Park.

Examiners = Letter Transmitting Proposal for Decision

Attached is a Proposal for Decision (PFD) submitted by the Examiners in this docket. This is only a proposal and should not be interpreted as a final decision unless a final order is signed and issued by the Commission.

NOTE: Pursuant to 16 Tex. Admin. Code ' ' 1.141(a) and 1.142(a), you may file written exceptions to the proposed order or present briefs to the Commission. You must file your exceptions, briefs, and/or summaries with the Docket Services Section of the Office of General Counsel (Room 12-112) by Wednesday, October 25, 2000. Replies to exceptions must be filed by Friday, November 3, 2000.

In addition to written exceptions, you may file with the Commission a one page summary of the case. The summary shall be filed with the Commission at the time exceptions are due. The summary shall be no more than one page and shall contain only information of record or argument based on the record. The summary shall not be submitted in reduced print. The summary shall contain the name of the party, the status of the party, the name and docket number of the case, the issue(s), the key facts, the legal principles involved (including proposed conclusions of law), and the action requested.

Pleadings are considered filed only upon actual receipt by the Docket Services Section. An original and six copies should be filed.

Any revisions or modifications made by the Examiner in response to the exceptions, replies, briefs, and/or summaries will be served on all parties. If you desire service of revisions and modifications by fax, please provide a written request for fax service (include your fax number).

The attached proposed order and any revisions or modifications made by the examiner in response to the exceptions, briefs, and/or summaries will be considered by the Commission at the November 9, 2000 conference.

You will be notified by mail of any final decision or order of the Commission. If regular mail delivery is unsatisfactory, you may provide a charge account number for an expedited or overnight delivery service. The Commission will thereafter utilize that delivery service, billed to your account, for transmittal of proposals for decisions and orders.

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attachments

RAILROAD COMMISSION OF TEXAS

APPEAL OF TXU GAS DISTRIBUTION	§	
FROM THE ACTION OF THE CITY OF	§	
DALLAS, CITY OF UNIVERSITY PARK,	§	
AND THE TOWN OF HIGHLAND	§	
PARK, TEXAS AND THE STATEMENT	§	GAS UTILITIES DOCKET NOS. 9145-
OF INTENT FILED BY TXU GAS	§	9148
DISTRIBUTION TO INCREASE RATES	§	
CHARGED IN THE ENVIRONS OF THE	§	
CITY OF DALLAS	§	

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RAILROAD COMMISSION OF TEXAS

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OF THE CITY OF DALLAS, CITY OF	§	
UNIVERSITY PARK, AND THE	§	
TOWN OF HIGHLAND PARK,	§	GAS UTILITIES DOCKET NOS. 9145-
TEXAS AND THE STATEMENT OF	§	9148
INTENT FILED BY TXU GAS	§	
DISTRIBUTION TO INCREASE	§	
RATES CHARGED IN THE	§	
ENVIRONS OF THE CITY OF	§	
DALLAS	§	

PROPOSAL FOR DECISION

I. Introduction

This is an appeal, filed by TXU Gas Distribution, of a decision by the City of Dallas brought pursuant to Texas Utilities Code (TUC) Section 103.054. The initial rate request was filed with the City of Dallas on August 27, 1999. The case filed with the City of Dallas was based on a test year ending December 31, 1998, and requested a \$6,244,301 annual increase in revenues. This request was based, in part, on an increase in the Applicant's cost of service, which allegedly resulted from \$52.8 million in capital expenditures. As originally filed with the Railroad Commission of Texas, TXU Gas Distribution requested that, instead of a \$6,244,301 increase, a \$12,578,717 increase was required due to its increased cost of service.¹ TXU Gas Distribution subsequently updated its request through December 31, 1999, for known and measurable changes. The revised filing reflected an increase in the cost of service of \$9,128,996. Due to changes made before and during the hearing, the estimated cost of service was revised to reflect an increase of \$8,098,030.

The City of Dallas intervened in this case and argued that, instead of the \$6,244,301 increase requested at the city level, or the revised \$8,098,030 increase requested in the appeal, TXU Gas Distribution has experienced a reduction in its cost of service which should result in a \$5,513,335 decrease to its cost of service. The Examiners' recommendation contained in this Proposal for Decision (PFD) indicates that TXU Gas Distribution's cost of service has increased \$1,300,505.

¹ TXU Gas Distribution Ex. 3, Primary Exhibits, p. 1.

II. Procedural History and Notice

A. Procedural History

On August 27, 1999, TXU Gas Distribution filed with the Cities of Dallas, University Park and Cockrell Hill, and the Town of Highland Park its Statement of Intent to change residential and commercial rates in the Dallas System. On February 23, 2000, the City of Dallas initially denied the proposed rate increase. As required by Chapter XIV, Section 3, of the Dallas City Charter, TXU Gas Distribution filed a Motion for Rehearing with the Dallas City Council on February 28, 2000. On March 8, 2000, the Dallas City Council denied the Motion for Rehearing and issued a final order denying the requested rate change. On March 21, 2000, the City of University Park denied the requested rate change. On March 28, 2000, Cockrell Hill approved a negotiated rate based on the Statement of Intent. TXU Gas Distribution noted in its Initial Brief that Cockrell Hill is not included in this appeal, except to the extent that rates for the Dallas System are based on the Dallas System as a whole. Customers in Cockrell Hill will pay the negotiated rates.²

On April 7, 2000, pursuant to Texas Utilities Code §§ 103.051 & 103.054, and the rules of the Railroad Commission of Texas (Commission), TXU Gas Distribution timely filed with the Commission its Petition for Review of Municipal Rate Decisions, including its direct testimony and Rate Filing Package. This petition was assigned Gas Utilities Docket Nos. GUD 9145-47. On April 7, 2000, pursuant to Texas Utilities Code § 104.001 *et seq.*, TXU Gas Distribution also filed with the Commission its Statement of Intent to Change Rates to Conform Environs with Municipal Rates and Motion to Consolidate. This Statement of Intent was assigned GUD No. 9148. On May 2, 2000, pursuant to Texas Utilities Code § 104.107(a)(2), the Commission ordered that the rates proposed in TXU Gas Distribution's Petition for Review be suspended for 150 days from the date the rates would otherwise go into effect. On June 16, 2000, Docket Nos. 9145-48 were consolidated for procedural purposes.

The City of Dallas filed a request to intervene in this docket on April 14, 2000, which was granted by Examiners' Letter No. 4. University Park and Highland Park did not intervene or otherwise participate in this proceeding. Discovery began on April 17, 2000. On April 20, 2000, the parties filed a *Joint Motion Regarding Procedural and Related Matters (Joint Motion)*. The *Joint Motion* was signed by counsel for the Applicant and the Intervenor. In that motion the parties requested that the test year ending December 31, 1998 be adjusted for known and measurable changes through December 31, 1999. Accordingly, the Hearings Examiner ordered the Applicant to file its updated package on May 12, 2000. The Examiners issued an agreed joint procedural schedule in this case on May 11, 2000. The schedule adopted reflected the agreement of the parties to toll the statutory deadline through two abatement periods.

On May 12, 2000, pursuant to Examiners' Letter No. 5, TXU Gas Distribution served an update to its Rate Filing Package, which had been filed with its Petition for Review, to reflect known and measurable changes to its test year cost of service through the period ending December 31, 1999. The update was filed with the Commission on May 24, 2000. The City of Dallas filed direct testimony on July 12 and 14, 2000. TXU Gas Distribution filed its rebuttal

² TXU Gas Distribution, Initial Brief, p. 4.

testimony on July 31, 2000. On July 21, 2000, the Applicant filed its *Motion in Limine* and on July 25, 2000, the Applicant filed its *Motion to Strike Testimony and for Partial Summary Judgment*. The Examiners denied the pre-hearing motions on August 1, 2000.³ The hearing on the merits convened on August 1, 2000 and continued through August 10, 2000. The City of Dallas filed its *Objections and Motion to Strike Rebuttal Testimony* on August 3, 2000. The Examiners denied that motion on August 7, 2000.⁴

B. Notice

On April 7, 2000, pursuant to Utilities Code § 103.054, TXU Gas Distribution delivered a copy of its Petition for Review to each of the Cities. Individual notice also was sent to the 211 environs customers affected by TXU Gas Distribution's Statement of Intent, and was approved on July 18, 2000. Notice of Hearing in this matter was provided July 14, 2000.

III. Jurisdiction

The Commission has jurisdiction over the matters at issue in this proceeding under TUC §§ 102.001(a), 121.051, and 121.151. The statutes and rules involved include, but are not limited to Tex. Util. Code Ann. §§ 103.022, 103.054, & 103.055, (Vernon 1998) and 16 Tex. Admin. Code § 7.57 (West 1999). The Notice of Hearing was issued in this Docket on July 14, 2000, and satisfied the requirements of 16 Tex. Admin. Code § 1.45 and of Tex. Gov't Code Ann. § 2001.052 (Vernon 2000).

As noted in the procedural discussion above, the parties agreed that the test year be adjusted for known and measurable changes through December 31, 1999. The Examiners note that Section 103.055 allows the Commission to consider an appeal de novo based on the test year presented for known "changes and conditions." To the extent that the rates proposed at the Commission level result in a higher revenue requirement than requested at the City of Dallas, the Commission is without jurisdiction to grant the higher request, unless it is linked to a known and measurable change. Changes in methodology that result in a higher request cannot form the basis of the Commission's decision. Nevertheless, the Examiners are of the opinion that the rates recommended by the Examiners result in a revenue increase that is less than the \$6,244,301 originally requested before the City of Dallas and, therefore, the recommended rates are within the jurisdiction of the Commission.

IV. Summary of Examiners' Recommendations

The Examiners' Recommendation in this Proposal for Decision results in a cost of service increase of \$1,300,505. TXU Gas Distribution's rate filing with the City of Dallas reflected an increased cost of service of \$6,244,301. As the updated filing reflects, TXU Gas Distribution is now requesting a \$8,098,030 increase to its cost of service in this proceeding. TXU Gas Distribution stated that the key reason for the requested increase is the expenditure of over \$52 million dollars in capital improvements since the last rate increase approved by the City of Dallas.

³ Tr. Vol. 1, p. 8.

⁴ Tr. Vol 5, p. 108.

The effect of this requested increase is most apparent in two key areas: The return on investment requested and the depreciation expense.⁵ TXU Gas Distribution is requesting an increase of \$4,944,434 in return compared to present rates.⁶ This increase on the return required is the result of the increased capital expenditures claimed and the increase in the rate of return requested. TXU Gas Distribution states that the current rate of return is 4.86%. The Applicant seeks to increase that rate to 9.82%. The depreciation expense has also increased. In 1994, TXU Gas Distribution requested a depreciation expense from residential and commercial customers of \$3,697,571.⁷ In this case, TXU Gas Distribution seeks a depreciation expense of \$6,647,877.⁸

The Examiners' recommendation contained in this Proposal for Decision provides an increase in return of \$3,444,922. The Examiners are recommending that depreciation expense be increased from the amount requested in 1994. The depreciation expense for residential and commercial customers recommended by the Examiners is \$4,638,353, which is \$940,782 greater than the depreciation expense requested in 1994. The Examiners are recommending other adjustments to the Applicant's cost of service that result from recommendations by the Examiners regarding various issues raised by the Intervenors.

Finally, the Examiners are recommending that the proposed allocation be adjusted. First, no portion of the Dallas South System should be directly assigned to industrial and transportation customers on the basis of a separate peak day study. The Examiners agree, however, that a portion of the mains should be assigned to the customer class through the zero intercept calculation and allocated as proposed by the Applicant. Second, the Examiners recommend that demand costs be allocated as proposed by the City of Dallas and that the peak day allocation be averaged with the total throughput.

Those issues are as follows, and the corresponding recommendations, are summarized below:

⁵ Changes in these two components of the cost of service have cascading effects throughout the cost of service calculation.

⁶ TXU Gas Distribution, Revised Ex. 3, p. 1.

⁷ City of Dallas Ex. 1, p. 5.

⁸ TXU Gas Distribution, Revised Ex. 3, p. 1.

Rate Base Issues*Original Cost*

Issue: Should TXU Gas Distribution allocate the general costs such as general plant, general plant RWIP, materials and supplies, and prepayments to the Dallas Distribution System based upon a customer allocation factor?

Examiners' Recommendation: No. The allocation of general costs of TXU Gas Distribution should be based upon a distribution allocation factor.

Applicant	Intervenor	Examiners
Based upon a customer allocation factor of 17.1419%	Based upon a distribution allocation factor of 15.919%	Based upon a distribution allocation factor of 15.919%

Cash Working Capital

Issue: Should Revenue lag days for cash working capital be 30.289 days?

Examiners' Recommendation: Yes. A revenue lag day of 30.289 days with a receipt of funds lag of 1.448 lag days is reasonable.

Applicant	Intervenor	Examiners
30.289 Revenue lag days	28.84 Revenue lag days	30.289 Revenue lag days

Issue: Should the lead-lag study recommend different service periods for the payroll related expense lead days?

Examiners' Recommendation: Yes, the Railroad Commission of Texas has held that there are different service periods associated with vacation pay and bonus, as compared with an employee's regular wages.

Applicant	Intervenor	Examiners
13.177 lead days not recognizing different service periods for vacation pay and bonus.	25.097 lead days recognizing different service periods for vacation pay and bonus.	25.097 lead days recognizing different service periods for vacation pay and bonus.

Issue: Should the lead lag study include a pre-qualification period and measure the lead days between when an employee makes a claim for a benefit and the time that TXU Gas Distribution must pay that claim?

Examiners' Recommendation: Yes. The lead lag study should include a pre-qualification period, which the Applicant has reasonably calculated, and include a calculation for the number of lead days between when an employee make a claim for a benefit and the time that claim is paid.

Applicant	Intervenor	Examiners
22.181 lead days not including a specific lead day calculation for lead days between claim and payment	96.021 including pre-qualification applied to ALL employees and a specific lead day calculation for lead days between claim and payment	22.679 lead days recognizing that the applicant has correctly calculated the pre-qualification period and including a specific lead day calculation for lead days between claim and payment

Issue: Should the date that the product or service is received be used in calculating the expense lead days or should the mid-point of the month in which the non-payroll expenses were recorded be applied? Further, should the day actually paid or the due date indicated on the bill be used in determining the lead days?

Examiners' Recommendation: The date the product or service is received should be adopted as the relevant due date.

Applicant	Intervenor	Examiners
32.845 lead days using the mid-point of the month methodology	52.712 lead days using the date the produce or service is received	43.651 lead days using the date the product or service is received and correcting an error in the Intervenor's calculation

Issue: Should a composite lead day be adopted when an actual lead day is available for revenue-related taxes attributable to the Dallas Distribution System?

Examiners' Recommendation: The actual lead days should be used where available.

Applicant	Intervenor	Examiners
20.055 expense lead using a composite	84.745 lead days using actual expense lead days for the DDS	84.704 lead days using actual expense lead days, corrected

Issue: Should the FIT expense lead day calculated for TXU LSP in GUD No. 8976 be adopted for TXU Gas Distribution?

Examiners' Recommendation: TXU Gas distribution has established that it reasonably calculated the expense lead days for FIT.

Applicant	Intervenor	Examiners
37 lead days based on TXU Gas Distribution Data	85.407 lead days based on TXU LSP lead days in GUD No. 8976.	37 lead days

Issue: Should non-cash expense be included in the cash working capital analysis?

Examiners' Recommendation: Non-cash expense should not be included in the cash working capital analysis.

Applicant	Intervenor	Examiners
FIT-Deferred-\$58,306 Return-(\$66,344) Depreciation-\$600,479	FIT-Deferred-\$0 Return-\$0 Depreciation-\$0	FIT-Deferred-\$0 Return-\$0 Depreciation-\$0

Issue: Should a cash allowance be permitted for average daily bank balances?

Examiners' Recommendation: No. Ratepayers should not be required to compensate shareholders for interest on funds they were not asked to provide.

Applicant	Intervenor	Examiners
Average Daily Bank Bal \$276,031	Average Daily Bank Bal \$0	Average Daily Bank Bal. \$0

Issue: Should sales taxes be removed from the calculation of working funds and others?

Examiners' Recommendation: Yes. Sales taxes should be removed from working funds and others. The Intervenor has not established that an a credit should be made to this amount due to pre-payment benefits.

Applicant	Intervenor	Examiners
Working funds (\$4,756)	Working funds (\$316,810)	Working funds (\$4,756)

Rate of Return

Issue: What is the appropriate rate of return for TXU Gas Distribution?

Examiners' Recommendation: The rate of return, based on a 12.1 percent cost of equity, should be set at 9.75%.

Applicant	Intervenor	Examiners
9.82 % rate of return based upon 12.25% cost of equity	9.13% rate of return based upon 10.9% cost of equity	9.75% rate of return based upon 12.1% cost of equity

Regulatory Expenses

Issue: Should the cost of service requested in this case be offset by profits related to the sale of land owned by TXU Gas Distribution?

Examiners' Recommendation: No. Pursuant to the criteria set forth in Gulf States, the Intervenor has not established that ratepayers have borne any risks associated with the property.

Applicant	Intervenor	Examiners
No adjustment	\$1,220,658 adjustment through an annual amortization of \$406,886.	No adjustment: Record does not reflect that ratepayers have paid any portion of the property.

Issue: Should the base load for calculating the weather normalization adjustment be determined using the base load over the period of June 1999 through September 1999 or the base load of a single month?

Examiners' Recommendation: As described in the Railroad Commission's Natural Gas Rate Review Handbook, base load is correctly calculated using those months in which no heating degree days occurred.

Applicant	Intervenor	Examiners
No adjustment	\$439,834 increase in present base rate revenues.	No adjustment. Record reflects that the base load was correctly calculated.

Issue: Should the test year consumption statistics be adjusted to reflect that consumption patterns are not uniformly declining from year to year?

Examiners' Recommendation: No. Consumption statistics should be based on test year patterns.

Applicant	Intervenor	Examiners
No adjustment	\$637,194 in additional base rate revenues due to a consumption normalization adjustment.	No adjustment. Consumption should be based upon test year measures.

Issue: Should the base city-gate rate be calculated using current gas costs of \$4.0200 or should the base gas cost set in GUD No. 8664 of \$2.7535 be used?

Examiners' Recommendation: It is reasonable to use base gas cost set in GUD No. 8664. Ultimately, the base city-gate rate used will not have an impact on the rates because of the purchase gas adjustment and the tax adjustment clauses in the rate design.

Applicant	Intervenor	Examiners
No adjustment	\$239,210 in additional base rate revenues due to the elimination of gas cost impacts from the cost of service.	No adjustment.

Issue: Should revenues collected from transactions with Industrial, Electric Generation and Transportation customers be allocated to residential and commercial customers?

Examiners' Recommendation: No. Costs of providing service are allocated to all classes of customers. Any further allocation of revenues earned from Industrial, Electric Generation and Transportation customers should not be allocated to residential and commercial customers.

Applicant	Intervenor	Examiners
No adjustment	\$4,476,655 adjustment to revenues collected.	No adjustment.

Issue: Should the labor expense be adjusted to reflect changes in labor in post test year months?

Examiners' Recommendation: No. The proposed adjustment is outside of the test year and selectively considers only one aspect of post-test year expenses.

Applicant	Intervenor	Examiners
No adjustment	\$464,609 adjustment to labor related expenses collected.	No adjustment.

Issue: Should the depreciation calculations for the Dallas Distribution System be changed from the ALG methodology adopted in the last municipal rate case or should it be changed to ELG?

Examiners' Recommendation: The ALG methodology should be retained for the Dallas Distribution System. As calculated by the City of Dallas, the proposed change results in an approximately \$881,840 rate increase.

Applicant	Intervenor	Examiners
No adjustment	\$881,480 adjustment to depreciation expense using the ALG methodology.	\$881,480 adjustment to depreciation expense using the ALG methodology.

Issue: Should the average service life for Account 376.3 be 60 years or 70 years?

Examiners' Recommendation: The average service life for this account should be within the reasonable range originally established by the Applicant.

Applicant	Intervenor	Examiners
60 year average service life with a corresponding R2.5 <i>Iowa curve</i> .	\$390,040 adjustment based on the use of 70 year average service life with corresponding R2 <i>Iowa curve</i> .	\$390,040 adjustment based on the use of a 70 year average service life with corresponding R2 <i>Iowa curve</i> .

Issue: Should the average service life for Account 376.4 be 45 years or 70 years?

Examiners' Recommendation: The average service life for this account should be 45 years.

Applicant	Intervenor	Examiners
45 year average service life with a corresponding R4 <i>Iowa curve</i>	\$51,000 adjustment based on the use of 70 year average service life with corresponding R1.5 <i>Iowa curve</i>	45 year average service life with a corresponding R4 <i>Iowa curve</i>

Issue: Should the average service life for Account 376.5 be 60 years or 70 years?

Examiners' Recommendation: The average service life for this account should be 70 years.

Applicant	Intervenor	Examiners
60 year average service life with a corresponding R2 <i>Iowa curve</i>	\$128,485 adjustment based on the use of 70-year average service life with corresponding R1.5 <i>Iowa curve</i>	\$128,485 adjustment based on the use of 70-year average service life with corresponding R1.5 <i>Iowa curve</i>

Issue: Should the average service life for Account 380 be 33 years or 38 years?

Examiners' Recommendation: The average service life for this account should be 33 years.

Applicant	Intervenor	Examiners
38 year average service life with a corresponding R2 <i>Iowa curve</i>	\$301,810 adjustment based on the use of 38-year average service life with corresponding L1.5 <i>Iowa curve</i>	\$301,810 adjustment based on the use of 70-year average service life with corresponding L1.5 <i>Iowa curve</i>

Issue: Has TXU Gas Distribution met the standard regarding affiliate transactions?

Examiners' Recommendation: Yes. The Applicant has demonstrated that its affiliate expenditure were reasonable and necessary and that the price charged was not higher than the prices charged to other affiliate or to non-affiliated persons.

Applicant	Intervenor	Examiners
Affiliate transaction should be included in cost of service.	All affiliate expenses included in the Applicant's cost of service should be disallowed.	Allow affiliate transactions – proof sufficient.

Issue: Should the medical trend used in the SFAS 106 be 1.5% or 5%?

Examiners' Recommendation: A 5% medical cost trend is well below the industry average of 7%.

Applicant	Intervenor	Examiners
7% medical cost trend.	\$115,359 adjustment based on the use a 1.5% medical cost trend.	7% medical cost trend.

V. Introduction, Structure of TXU Corporation, TXU Gas Distribution and Overview of Services

In order to fully assess the transactions and intra-company assignments reflected in the Applicant's cost of service, a basic understanding of the different relationships of the entities that make up TXU Corporation is required. The parties do not dispute that TXU Gas Distribution is an unincorporated division of TXU Gas Company, which is an affiliate of TXU Corporation. The parties do not dispute the basic structure of the legal and functional organization of TXU Corporation as outlined by the Applicant.

A. Structure of TXU Corporation

TXU Gas Distribution is an unincorporated division of TXU Gas Company and is the division responsible for local gas distribution operations.⁹ TXU Gas Distribution was formerly known as Lone Star Gas Company and then TXU Lone Star Gas, before adopting its current name in 1999.¹⁰

⁹ TXU Gas Distribution, Ex. 5, p. 4-5.

¹⁰ TXU Gas Distribution, Ex. 1, p. 9.

From an organizational perspective, TXU Corporation created the Distribution Business Unit following the merger of Texas Utilities Company and ENSERCH Corporation.¹¹ The Distribution Business Unit includes TXU Electric Company and TXU SESCO, both electric utilities providing local distribution service in Texas.¹² This organization carries out the distribution functions of both TXU Electric Company and TXU Gas Company.¹³ The Distribution Business Unit was formed primarily to take advantage of the similar characteristics and missions of the gas and electric local distribution companies within the TXU System.¹⁴ To the extent possible services are shared between gas and electric distribution operations.¹⁵ Figure 1, below, sets out the legal relationships of TXU Gas Distribution relative to other TXU System entities.

Organization Chart--Legal

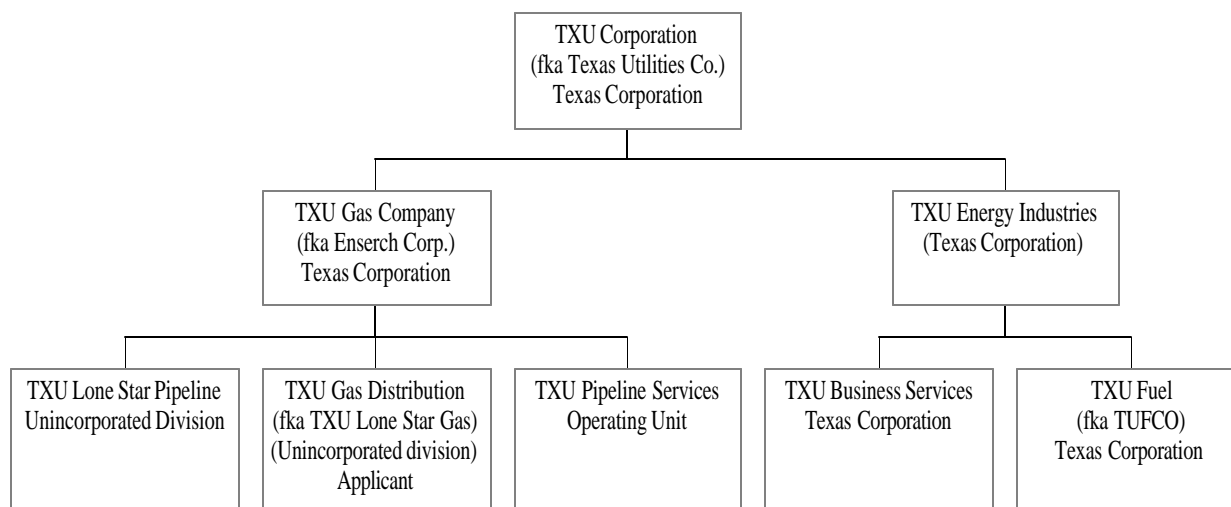


Figure 1

B. Overview of the system

TXU Gas Company, formerly ENSERCH, is an integrated company engaged in gathering, processing, transmission, and distribution of natural gas, and marketing of gas and electricity. TXU Gas Distribution provides local gas distribution service in over 550 municipalities in the State of Texas and in the environs of these municipalities. TXU Gas Distribution serves approximately 1,380,000 customers in an area covering over 73,000 square miles in the State of Texas and the system includes approximately 24,400 miles of distribution pipeline.¹⁶

¹¹ TXU Gas Distribution, Ex. 5, p. 5

¹² TXU Gas Distribution, Ex. 1, p. 9.

¹³ TXU Gas Distribution, Ex. 5, p. 5.

¹⁴ TXU Gas Distribution, Ex. 1, p. 9.

¹⁵ TXU Gas Distribution Ex. 5, p. 5.

¹⁶ TXU Gas Distribution Ex. 5, p. 4; TXU Gas Distribution, Ex. 19, DAW-S-1, p. 1; & TXU Gas Distribution Ex. 23, p. 9.

The Dallas System is an integrated local gas distribution system and is the largest local gas distribution system operated by TXU Gas Distribution.¹⁷ The distribution system is comprised of approximately 3,400 miles of pipe, and encompasses over 370 square miles, and serves approximately 236,200 customers in Dallas, Highland Park, University Park, and Cockrell Hill. The Dallas System customer base is comprised of approximately 211,000 residential customers, 25,000 commercial customers, and 200 industrial and transportation customers.¹⁸ During 1999, residential and commercial customers accounted for approximately 97 percent of TXU Gas Distribution's gas sales revenues of \$534 million, with the remainder being attributable to industrial and electric-generation customers.

A map attached to this Proposal for Decision provides an overview of the entire Dallas Distribution System (DDS). As described by Mr. Dixon, Vice-President of Gas Operations for TXU Gas Distribution, the majority of the Dallas System consists of low and intermediate pressure distribution networks located within Dallas, Highland Park, University Park, and Cockrell Hill designed to serve residential and commercial customers. The Dallas System also includes larger diameter pipe located throughout the Dallas area that is dedicated to serving the Dallas System. Mr. Dixon testified that the larger diameter pipe makes up the entire Dallas South High Pressure Distribution System ("Dallas South System").

The Dallas South System is the green segment on the map. The Dallas South System runs from the Mesquite in East, moves South and West toward Grand Prairie, and then North to Irving. The Dallas South System delivers large volumes of gas to the Dallas System, the city gates of Irving, Duncanville, and Grand Prairie, and the TXU Parkdale and Mountain Creek electric power plants.

There are a number of city gates throughout the Dallas System where gas is taken from TXU Lone Star Pipeline. Once gas is metered into the Dallas System, the pressure is reduced through regulators in order to meet system requirements as determined by pressure and volume needs. The gas is then delivered and metered to the customer for burner-tip consumption.

¹⁷ TXU Gas Distribution, Ex. 5, p. 5.

¹⁸ TXU Gas Distribution, Ex. 5, p. 6.

VI. Rate Base

A. Invested Capital

1. Original Cost

Issue: Should TXU Gas Distribution allocate the general costs such as general plant, general plant RWIP, materials and supplies, and prepayments to the Dallas Distribution System based upon a customer allocation factor?

Examiners' Recommendation: No. The allocation of general costs of TXU Gas Distribution should be based upon a distribution allocation factor.

Applicant	Intervenor	Examiners
Based upon a customer allocation factor of 17.1419%	Based upon a distribution allocation factor of 15.919%	Based upon a distribution allocation factor of 15.919%

As noted in Section V above, the TXU Gas Distribution system provides local gas distribution service to over 550 municipalities and to the environs of these municipalities. The Dallas Distribution System (DDS) is one of these 550 local distribution systems. The Applicant must assign a portion of the costs associated with general plant, retirement work in progress. (RWIP)¹⁹, materials and supplies, and prepayments for the entire TXU Gas Distribution system to the Dallas Distribution System. The Applicant argues that a customer allocation factor based upon the ratio of total Dallas Distribution System customers to TXU Gas Distribution Customers should be applied to assign these costs to the DDS system. The City of Dallas argues that a ratio based upon total DDS distribution plant to TXU Gas Distribution plant be used to assign these costs. The parties' respective positions regarding assignment of these costs are set forth in Table 6.1.

¹⁹ RWIP represents the retirement of a facility that will not be fully retired until after the end of the test year. Tr. Vol. 4, p. 27.

Table 6.1

Assignment of TXU Gas Distribution Costs to the Dallas Distribution System

	TXU Gas Distribution ²⁰ (Total Costs)	Amount Assigned: Applicant's Position ²¹	Amount Assigned: Intervenor's Position ²²
General Plant	\$59,746,865	\$10,245,333	\$9,511,103
General Plant RWIP	(\$1,452,876)	(\$249,138)	(\$231,283)
Materials and Supplies	\$1,863,506	\$319,552	\$296,652
Prepayments	\$4,205,613	\$721,174	\$669,492

a. Applicant's position

TXU Gas Distribution explains that the process of assigning costs is necessary because, although rates are set within each separate municipality in TXU Gas Distribution's service area, TXU Gas Distribution keeps only one set of books at the company level.²³ In order to assign these costs, the Applicant used a customer allocation factor to allocate the costs related to these items.²⁴ The total number of customers on the Dallas Distribution System make up 17.1479% of all TXU Gas Distribution system customers. Mr. Florence testified that the use of a customer-based factor to assign these costs is appropriate because the general plant, and associated RWIP expenses, is installed to serve all customers.²⁵ He points out that these items are not designed to serve specific customers in a specific distribution system; rather, they are designed to serve all customers across the system. He argues that distribution plant is predominantly gas mains, regulators, service lines, and measuring stations. General plant, on the other hand is predominantly computer software, transportation equipment, structures and improvements, inventories, and furniture.²⁶

Mr. Florence adds that the use of a customer allocation factor for general plant is also supported by the November 1999 Railroad Commission "Natural Gas Rate Review Handbook," which states that in "the case of a general plant, the most frequent allocation method is seen on the basis of number of customers. This allocation is acceptable, since most general plant expenses are customer based."²⁷

²⁰ TXU Gas Distribution Revised Ex. 4, Cost of Service Exhibits, pp. 7-3, 7-6, 7-7.

²¹ Id.

²² City of Dallas Ex. 29, Exhibit JP-21.

²³ TXU Gas Distribution Reply Brief, p. 55.

²⁴ TXU Gas Distribution Revised Ex. 4, Cost of Service Exhibits, pp. 7-9. The schedule on that page indicates that the ratio of Dallas Distribution System customers (237,415) to total customers served by TXU Gas Distribution (1,384,515) is 0.17479.

²⁵ TXU Gas Distribution Ex. 41, p. 12.

²⁶ Id.

²⁷ Natural Gas Rate Review Handbook, pp. 15-16.

He argues that prepayments and materials and supplies are items that are used to serve all customers across the system and that there is no demonstrated correlation between either prepayments or materials and supplies and distribution plant. Prepayments are related to such items as insurance, dues, and gross receipt taxes. Materials and supplies are miscellaneous supplies used to serve all customers. Again, he argues that a customer allocation factor is preferable to a distribution-investment allocation factor.²⁸

b. Intervenor's position

Mr. Pous, testifying on behalf of the City of Dallas, argued that a distribution plant-related allocation factor is a more appropriate factor for the assignment of costs of plant-investments at the divisional level to the Dallas Distribution System.²⁹ He alleges that general plant investments exists to support the distribution plant and concludes that the number of customers in the Dallas Distribution System compared to the total number of distribution customers does not present a reasonable cost causation relationship.³⁰ Mr. Pous points out that TXU Gas Distribution has calculated the ratio of the Dallas Distribution System investment to the gross distribution system of TXU Gas Distribution as 0.15919.³¹ Accordingly, Mr. Pous recommends that those costs be allocated on the basis of 15.919% to the Dallas Distribution System.

c. Examiners' Analysis and Recommendation

Despite TXU Gas Distribution's proposal to allocate general plant to the Dallas Distribution System based on the number of customers, the Applicant proposes to assign general plant expenses within the Dallas Distribution System using the same ratios as distribution plant investment. Indeed, the Applicant tendered an exhibit in support of this assignment methodology which stated that "[s]ince this investment (general plant) *supports and follows distribution plant investment*, it is assigned and classified for later allocation using the same ratios as distribution plant investment."³² The Examiners recommend that the same methodology adopted to assign the costs within the Dallas Distribution System be applied in assigning the costs to the Dallas Distribution System. While it is correct that the Natural Gas Rate Review Handbook (Handbook) states that the most frequent allocation method seen in allocating general plant is on the basis of number of customers, the Handbook does not imply that this is the exclusive method of allocating costs. Consistency in the rate setting process is an

²⁸ TXU Gas Distribution, Ex. 41, p. 13.

²⁹ City of Dallas, Ex. 29, p. 98.

³⁰ It should be noted, that despite Mr. Pous' testimony and recommendations in Schedule JP-21, the Cost of Service Schedules prepared by Mr. Pous, attached to his testimony as JP-1and revised at City of Dallas, Exhibit 31, reflect that the City of Dallas adopted the figures, and consequently the methodology, proposed by the City of Dallas. The Examiners assume that this was an oversight in preparing the cost of service schedule. The Examiners cannot ascertain how \$966,142, which appears on Exhibit JP-21, line, col "Total System" was calculated for materials and supplies and prepayments on the schedule prepared by Mr. Pous.

³¹ TXU Gas Distribution, Ex. 4, Cost of Service Exhibits, pp. 7-9.

³² TXU Gas Distribution, Ex. 31, p. 3.

appropriate factor to consider.³³ In this case, it would be inconsistent to treat the assignment of system-wide general plant on a customer basis and then assign general plant at the local distribution level on the basis of distribution plant investment ratios.

Likewise, TXU Gas Distribution assigned the costs for prepayments and materials and supplies at the local distribution level on the basis of total plant in service. Assignment of these system-wide costs to the Dallas Distribution System on the basis of the total number of TXU Gas Distribution customers is inconsistent with the methodology employed by the Applicant for allocating costs within the Dallas Distribution System. Accordingly, the Examiners recommend that costs for prepayment and for materials and supplies be allocated on the basis of total distribution plant investment ratio.³⁴

2. Cash Working Capital

Cash working capital represents an amount of cash that a utility must have available to meet current obligations as they arise, due to the time lag between payment of expenses and collection of revenues.³⁵ The need for working cash has long been recognized by regulatory bodies and the courts.³⁶ However, an allowance for cash working capital is not guaranteed as a matter of course and the utility carries the burden of establishing the need for cash working capital.³⁷ In order to determine the cash working capital needs of the Dallas Distribution System, TXU Gas Distribution prepared a lead-lag study.³⁸ A lead-lag study empirically identifies the difference in timing between outward cash flow for labor, materials and supplies, inventory, and other expenses, and inward cash flow of revenue from payments by customers.³⁹

Cash working capital requirements may be positive or negative.⁴⁰ Positive working capital is investor-supplied.⁴¹ In contrast, negative working capital reduces the need for investor-supplied capital and arises when the utility receives customer payments before service is rendered, or when it receives funds before it must satisfy a corresponding liability.⁴² To illustrate the concept of cash working capital, if one assumed that the utility paid for natural gas before it supplied the natural gas to the consumer, then the utility would be using positive cash working capital, i.e., money from its investors, to pay for the natural gas until the consumer paid

³³ *Texas Alarm and Signal Association v. P.U.C.*, 773 S.W.2d 766, 773 (Tex. 1980) (Utilities should be consistent in their applications and “may not, without supporting evidence, vary their mathematical formulas or relevant factors so as to fit their alleged needs.”)

³⁴ As can be seen from Examiners’ Schedule F-3, the total distribution plant ratios, found on line 18, are the same as the total plant investment ratios, found on line 30.

³⁵ *Alabama-Tennessee Natural Gas Co. v. Federal Power Commission*, 203 F.2d 494, 498 (3rd Cir. 1953); *People’s Counsel v. Public Service Commission*, 399 A.2d 43, 46 (D.C. Cir. 1979).

³⁶ *Smyth v. Ames*, 169 U.S. 466-418 (1898).

³⁷ *Southern Union Gas Co. v. Railroad Commission of Texas*, 701 S.W.2d 277 (Tex. App.—Austin 1986) (Gas Utility failed in its burden of proof regarding its working capital needs); *Peoples Counsel v. Public Serv. Comm’n*, 399 A.2d 43, 45.

³⁸ TXU Ex. 21, p. 3. (Umbaugh Direct).

³⁹ *Colorado Municipal League v. Public Util. Comm’n*, 687 P.2d 416, 420; *Cent. La. Elec. Co. Inc. v. La. Pub. Serv. Comm’n*, 373 So.2d 123, 130 (La. 1979).

⁴⁰ *Cincinnati Gas & Elec. Co. v. Pub. Util. Comm’n*, 620 N.E.2d 821 (Ohio 1993)

⁴¹ *Id.* at 419.

⁴² *Id.*

the utility. In that case, the investor would have an expectation of receiving a reasonable return on its investment. If, however, the consumer paid the utility in advance for use of the product, the company has negative cash working capital and the investor would have no expectation of return because the investor's capital was not being used.⁴³ Ultimately, a determination of working capital is an exercise of discretion as to what particular method yields the most fair and equitable result in each case.⁴⁴

In the course of this proceeding, the estimate of TXU Gas Distribution's cash working capital requirement varied dramatically. Testifying on behalf of the Applicant, Jan A. Umbaugh, a certified public accountant and partner with the firm of Deloitte & Touch LLP, initially testified that the cash working capital requirement was \$1,793,456.⁴⁵ In his supplemental direct, Mr. Umbaugh testified that the cash working capital requirement was \$1,704,488.⁴⁶ In his rebuttal testimony Mr. Umbaugh testified that the cash working capital requirement was a negative \$3,704,404.⁴⁷ Thus, TXU Gas Distribution's final cash working capital request differed from the original request by approximately \$5,497,860.

Jacob Pous, a professional engineer and principal in the firm of Diversified Utility Consultants, Inc., testified on behalf of the City of Dallas. In his pre-filed testimony he originally proposed a negative cash working capital of \$8,433,708.⁴⁸ At the time of the hearing, the City of Dallas modified its proposed cash working capital requirement to \$8,295,117.⁴⁹ As reflected in Examiners' Schedule F-4 attached to this PFD, the Examiners recommend a negative cash working capital requirement of \$7,034,775.

The lead-lag study evaluated the funds and activities in eleven categories: (1) Purchased Gas Costs, (2) Payroll, (3) Benefits, (4) Other Operations and Maintenance, (5) Federal Income Taxes, (6) Taxes Other than FIT, (7) Interest on Customer Advances and Deposits, (8) Depreciation Expense, (9) Return, (10) Average Daily Bank Balances, (11) Working Funds and Other. The Intervenor raised several issues concerning the Applicant's study. First, the intervenor argues that the number of revenue lag⁵⁰ days was incorrectly calculated. Second, the City of Dallas takes issue with the lead⁵¹ days calculated in the following categories of expenses: Payroll, Pension and Benefits, Other Operations and Maintenance, Federal Income Taxes, and Revenue-Related-Taxes. Table 6.2 summarizes the parties' relative positions regarding lead days:

⁴³ *Zia Natural Gas Company v. New Mexico Public Utility Commission*, et al., 2000 WL 358390 (March 1, 2000).

⁴⁴ *General Tel. Co. v. Arkansas Pub. Serv. Comm'n*, 23 Ark.App. 73, 744 S.W.2d 392, 397 (Ark.Ct.App.), *aff'd*, 295 Ark. 595, 751 S.W.2d 1 (1988).

⁴⁵ TXU Gas Distribution Ex. 20, p. 27.

⁴⁶ TXU Gas Distribution Ex. 21, p. 5.

⁴⁷ TXU Gas Distribution Ex. 22, Exhibit JAU-R-10.

⁴⁸ City of Dallas, Ex. 29 Exhibit JP-7.

⁴⁹ City of Dallas, Ex. 31 Revised Exhibit JP-7

⁵⁰ A revenue lag is the number of days of lag time between the recorded delivery of gas service and the subsequent receipt of payment. TXU Gas Distribution Ex. 20, p. 5.

⁵¹ An expense lead is the number of days of lead-time between the recording of expenses for goods or services provided to the utility by vendors and the payment by the utility for those goods and services. *Id.*

Table 6.2

Summary: Parties' Positions and Examiners' Proposal Regarding the Number of Lead days

Category	Applicant: lead days	Intervenor: lead days	Examiners' Proposal
Payroll	13.177	25.097	25.097
Pension and Benefits	22.181	96.021	22.679
Other O&M	32.845	52.712	43.651
Rev. Related Taxes	20.055	84.745	84.704
Federal Income Tax	37	85.407	37

Third, the Intervenors also argue that a cash working capital allowance should not be included for deferred federal income taxes, depreciation expense, or return. Fourth, the City of Dallas recommends an adjustment to the proposed Average Daily Bank Balances and to Working Funds and Other.

At the outset of this discussion, the Examiners note that the City of Dallas often refers to the Final Order and the Proposal for Decision issued in GUD No. 8976. The Examiners point out that the Railroad Commission, in Finding of Fact No. 71 of that final order, found that neither the applicant nor the intervenors in that case presented a reliable lead-lag study. Thus, the analysis of the lead-lag study in that case provides limited insight into the lead-lag study presented in this case.

a. Revenue Lag Days

Issue: Should revenue lag days for cash working capital be 30.289 days?

Examiners' Recommendation: Yes. Using a revenue lag of 30.289 days with a receipt-of-funds lag of 1.448 lag days to calculate cash working capital is reasonable.

Applicant	Intervenor	Examiners
30.289 Revenue lag days	28.84 Revenue lag days	30.289 Revenue lag days

The issue in dispute here is whether the Applicant's "check lag" adjustment used in calculation of revenue lag days should be allowed. The City of Dallas, in its Initial Brief, alleged that its cross examination of the Applicant's witness revealed an error that requires correction regarding the calculation of revenue lag days. Specifically, the City of Dallas argues that the Applicant incorrectly assumed that 100 percent of its revenues were generated in the form of payments by check, contrary to the witness' testimony; therefore, TXU Gas Distribution has failed to meet its burden of proof on this issue the and check lag adjustment should be removed.⁵²

i. Applicant's Position

TXU Gas Distribution proposed 30.289 revenue lag days. Mr. Umbaugh testified that revenue lag days consist of four components: (1) the service lag measured from the middle of the month for which service is billed, (2) the billing lag that reflects the time required to process and record bills, (3) the collection lag that identifies the time delay between the recording of bills and the receipt of the billed revenues, and (4) the delay in the bank's clearance of deposited check payments. The total number of days produced by the four components represents the amount of time between the delivery of service to customers and the receipt of the related revenues for such service.⁵³ TXU Gas Distribution estimated that the receipts of funds lag was equal to 1.448 days.⁵⁴

⁵² The Examiners do not agree that this issue could not have been raised in the pre-filed testimony as claimed by the City of Dallas. As is evident from a review of Mr. Pous' testimony City of Dallas (Exhibit No. 29, pp. 49-67), substantial discovery was conducted concerning the cash working capital requirement. Footnotes 74, 75, 83, 87, 93, 101 all make reference to responses to discovery propounded by the Intervenor. In addition, Mr. Umbaugh himself, in rebuttal testimony, made references to discovery propounded by the City of Dallas on pages 4, 5, 8, 10, 12, 14, 15, 16 and 19 and Exhibits JAU-R-1, JAU-R-2, JAU-R-3, JAU-R-4, JAU-R-5, JAU-R-6, JAU-R-7 and JAU-R-8. TXU Gas Distribution, Exhibit 22. In addition to the discovery referenced, several depositions were conducted in this case. Ample opportunity existed for the Intervenor to establish the pattern of payment employed by TXU Gas Distribution. However the Examiners also note that the Applicant had ample opportunity to re-direct its witness and clarify the issues raised during cross-examination.

⁵³ TXU Gas Distribution, Ex. 20, p. 9.

⁵⁴ TXU Gas Distribution, Ex. 22, Rebuttal Testimony Workpapers and/or Relied Upons for Jan A. Umbaugh, Schedule A.

The Applicant argues that the Intervenor's attempt to reduce cash working capital after the close of the evidentiary hearing must be rejected. First, the Applicant points out that the City of Dallas admits that the proposed adjustment was not sponsored or calculated by any Dallas witness and the adjustment is not reflected in any City of Dallas exhibit. Second, the adjustment is based on information that is not in evidence and not subject to cross-examination. TXU Gas Distribution argues that the adjustment is dependent on the incorrect assumption that all revenues are received either by wire transfers or lock boxes and that all wire transfer funds are immediately available. The City of Dallas introduced no evidence to prove this allegation.⁵⁵

ii. Intervenor's Position

The Intervenor, in its Initial Brief, argued that the Applicant incorrectly assumed that 100 percent of its revenues were generated in the form of payments by check and thus required an additional 1.448 day revenue lag for those checks to clear the bank before becoming available to the TXU Gas Distribution.⁵⁶ The City of Dallas alleges that, during cross examination, Mr. Umbaugh admitted that payments in the form of cash or wire transfers, in particular from large customers, would eliminate the need for the 1.448 revenue lag components. Further, the City of Dallas argues that Mr. Umbaugh admitted that the use of lock boxes and similar efforts undertaken by the Applicant speed up the payment process and accelerated the actual recognition of payments from customers. The Intervenor argue that, since the Applicant was unable to identify what portion of its revenues were made up of payments by checks then the entire 1.448 revenue lag component should be denied.⁵⁷

iii. Examiners' Analysis and Recommendation

The Examiners agree that a 1.448 revenue lag for receipt of funds is reasonable. Consequently, the Examiners recommend that a revenue lag of 30.289 days be adopted. The Applicant has established that its calculation was reasonable. Mr. Umbaugh testified that cash payments, lock boxes, and wire transfers would reduce the revenue lag time, however, "it still doesn't necessarily reduce it to zero or something less than a day."⁵⁸ In addition, Mr. Umbaugh pointed out that many check receipts that would come to the Applicant "would actually have a period much longer than the one day from the time that the check is received until it is processed and deposited in the bank and the bank clear that."⁵⁹

⁵⁵ TXU Gas Distribution, Reply Brief, pp. 70-71.

⁵⁶ City of Dallas, Initial Brief, p. 7.

⁵⁷ City of Dallas, Initial Brief, p. 8.

⁵⁸ Tr. Vol. 4, 64-65.

⁵⁹ Tr. Vol. 4, 65.

b. Payroll lead days

Issue: Should the lead-lag study recognize different service periods for the payroll related expense lead days?

Examiners' Recommendation: Yes. The Railroad Commission of Texas has held that there are different service periods associated with vacation pay and bonus, as compared with an employee's regular wages.

Applicant	Intervenor	Examiners
13.177 lead days not recognizing different service periods for vacation pay and bonus	25.097 lead days recognizing different service periods for vacation pay and bonus	25.097 lead days recognizing different service periods for vacation pay and bonus

The Applicant's expense lead days for payroll-related expenses are 13.177 days.⁶⁰ In the context of calculating payroll lead days, the City of Dallas recommends that the cash working capital calculations for labor expenses recognize different service periods for vacation and sick pay, thus increasing payroll-related lead days.

i. Applicant's Position

Mr. Umbaugh points out that employees of TXU Gas Distribution are not allowed to carry over vacation and health benefits earned in one year to a subsequent year with a minor exception that requires specific approval.⁶¹ Thus, vacation and health benefits earned in a calendar year must be taken in that calendar year or these benefits are forfeited.⁶² He concludes that the Applicant does not accrue vacation payroll in advance, but instead recognizes the vacation payroll expense as it is taken.⁶³

ii. Intervenor's Position

The Intervenor argues that the lead-lag study should have separately evaluated vacation patterns. Further, the City of Dallas points out that the Railroad Commission of Texas and the Public Utility Commission have already addressed this issue. Mr. Pous points to GUD No. 8878, *Appeal of Southern Union Gas Company from the Action from the City of El Paso, Texas*, November 17, 1998.⁶⁴ In that case, the Railroad Commission specifically found that there are "different service periods associated with vacation pay and bonus, as compared with an employee's regular wages."⁶⁵ Mr. Pous also points to PUC Docket No. 16705, *Entergy Gulf*

⁶⁰ TXU Gas Distribution, Rebuttal Testimony Workpapers, 20.

⁶¹ TXU Gas Distribution, Ex. 22, p. 8.

⁶² *Id.*

⁶³ *Id.*

⁶⁴ City of Dallas, Ex. 29, 58.

⁶⁵ GUD No. 8878, FOF 111.

States, Inc., where the PUC recognized a longer lead day level for this type of expense based on his testimony in that case.⁶⁶ Finally, Mr. Pous argues that the Examiners found in GUD No. 8976 that the correct level of lead days should have included a separate analysis for vacation pay. He therefore recommends that the same vacation lead day level that the Examiners found appropriate for TXU Lone Star Pipeline employees (who are paid on the same basis as TXU Gas Distribution employees) be applied in this case. He states that the correct payroll expense lead days is 25.097 when the different service periods are recognized.

iii. Examiners' Analysis and Recommendation

The Examiners recommend that the expense days associated with payroll be 25.097. The Applicant should have included a separate analysis for vacation leave for working capital requirements. The lag between when the employee earns the vacation time and when the utility pays him for it is relevant and requires a separate analysis. Mr. Umbaugh argues that the Applicant does not accrue vacation. However, the relevant point of reference in this analysis is the employee. The employee accrues vacation and that is what should be measured in the lead lag study: the lead-time between when the employee accrues the benefit and is later paid for such benefit. Mr. Pous properly calculated the lead using payroll figures provided by the Applicant.⁶⁷

⁶⁶ *Application of Entergy Texas for Approval of its Transition to Competition Plan and Tariffs Implementing the Plan, and for Authority to Reconcile Fuel Costs, to Set Revised Fuel Factors, and to Recover a Surcharge for Under Recovered Fuel Costs*, P.U.C. Docket No. 16705, 189 P.U.R. 4th 451.

⁶⁷ City of Dallas, Exhibit 29, JP-8. Gross payroll figurers on that schedule are from the Rebuttal Testimony Workpapers and/or Relied Upens, Schedule B-3.

c. Pensions and Benefits lead days

Issue: Should the lead lag study include a pre-qualification period and measure the lead days between when an employee makes a claim for a benefit and the time that TXU Gas Distribution must pay that claim?

Examiners' Recommendation: Yes. The lead lag study should include a pre-qualification period, which the Applicant has reasonably calculated, and include a calculation for the number of lead days between when an employee make a claim for a benefit and the time that claim is paid.

Applicant	Intervenor	Examiners
22.181 lead days not including a specific lead day calculation for lead days between claim and payment	96.021 lead days including pre-qualification lead days periods applied to ALL employees and a specific lead day calculation for lead days between claim and payment	22.679 lead days recognizing that the applicant has correctly calculated the pre-qualification period and including a specific lead day calculation for lead days between claim and payment

The lead-lag analysis for pension and benefits measures the time period between when the employee provided service and when the Applicant paid the benefit associated with such service. TXU Gas Distribution determined that the lead days for pensions and benefits was 22.181.⁶⁸ The City of Dallas argues that it should be 96.021.⁶⁹ The Examiners recommend that 22.679 days be adopted.

i. Applicant's position

Mr. Umbaugh testified that the lead days for pensions and benefits does not include the period of employment before an employee is eligible to receive benefits.⁷⁰ He points out that employees must generally complete a ninety-day or one-year period of employment before they become eligible for pension and other benefits.⁷¹ In his rebuttal testimony, Mr. Umbaugh stated

⁶⁸ TXU Gas Distribution, Ex. 21, Rebuttal Testimony and Workpapers and/or Relied Upens for Jan A. Umbaugh, Schedule B-2a.

⁶⁹ There appears to be some confusion over this figure. In its Initial Brief, the City of Dallas stated that the correct figure should be 94.804 lead days. Initial Brief, 11. This is consistent with pre-filed testimony. City of Dallas, Ex. 29, 59 & Exhibit JP7; City of Dallas Ex. 31, Revised Exhibit JP7. On the stand, Mr. Pous changed this amount and testified that the correct amount should be 96.021. Tr. 8, 62.

⁷⁰ TXU Gas Distribution, Ex. 20, p. 15.

⁷¹ Id.

that while he did not believe that pre-qualification periods should be added, the study conducted by the Applicant did add the pre-qualification periods in calculating benefit payment periods for all new employees in response to the Railroad Commission's Final Order in GUD No. 8976.⁷² He points out that the City of Dallas' witness assigns the extended service period lead days to the total amount of pensions and selected other benefits.⁷³ Thus, the impact of Mr. Pous' proposed adjustment effectively assumes that the entire test-year benefit cost is related to new employees, that they were hired at the beginning of the test year, and that the accrued benefits actually related to the pre-qualification period.⁷⁴ He notes that the vast majority of the Applicant's employees had been employed well before the beginning of the test year.

Mr. Umbaugh testified that the lead days with regards to medical and dental benefits have also been incorporated into the Applicant's lead-lag study. He notes that the Applicant accrues for estimated "incurred but not reported" (IBNR) claims by recognizing the expense and recording liability for estimated claims that have been incurred by employees, but that have not yet been submitted for reimbursement.⁷⁵ The accrual for these IBNR are then deducted from the cash working capital in the Applicant's lead-lag study as a component of "working funds and other." Mr. Pous' proposal to also add this lead period to the pensions and benefit lead days results in a double counting of this period. Mr. Umbaugh concludes that such a proposal is unreasonable in light of the fact that the Applicant has already recognized this delay and included it as a reduction of working funds and other.

ii. Intervenor's Position

The City of Dallas argues that the appropriate lead days for pensions and benefits is 96.021.⁷⁶ Mr. Pous bases his recommendation on two factors. First, he recommends an adjustment for new employees. In its Reply Brief, the City of Dallas argues that pre-qualification periods apply to all employees, whether they are new employees or existing employees, because all employees had to absorb the impact of the delay prior to receiving benefits.⁷⁷ In addition, Mr. Pous argues that a lead day should have been calculated for medical and dental benefits. In its Reply Brief, the City of Dallas argues that TXU Gas Distribution confuses its IBNR recognition in this case with the recognition of lead days associated with the time between when an employee or member of an employee's family utilizes health services and when such claims are submitted.⁷⁸ The IBNR amount reflects a dollar amount of a claim that the insurance administrator estimates exist, but has not been submitted as of that point in time.⁷⁹

⁷² TXU Gas Distribution, Ex. 22, p. 10.

⁷³ TXU Gas Distribution, Ex. 22, p. 11.

⁷⁴ *Id.*

⁷⁵ TXU Gas Distribution, Ex. 22, p. 9.

⁷⁶ As noted above in this section Mr. Pous, testifying on behalf of the City of Dallas, indicated that the correct figure was 96.021.

⁷⁷ City of Dallas, Reply Brief, p. 15.

⁷⁸ City of Dallas, Reply Brief, p. 14.

⁷⁹ *Id.* and TXU Gas Distribution Exhibit 22, Exhibit JAU-R-6.

iii. Examiners' Analysis and Recommendation

The Examiners recommend that a pre-qualification period be included in a lead-lag analysis of pensions. The Examiners believe that TXU Gas Distribution has taken the pre-qualification lead days into account. However, applying the pre-qualification period across the board to all employees would not be reasonable.⁸⁰ On the other hand, TXU Gas Distribution has not properly accounted for the lead days associated with other benefits. The IBNR does not measure lead days between when an employee makes a claim for a benefit and the time that the Applicant must honor that claim. Thus, the appropriate lead days associated with the pensions and benefits is 22.679 days.⁸¹

d. Other Operations and Maintenance Lead Days

Issue: How is the starting point of the lead period identified and how is the end point of the lead period identified?

Examiners' Recommendation: The starting point of the lead period should be identified by invoice date, conversely the end date should be based on the due date.

Applicant	Intervenor	Examiners
32.845 lead days using the mid-point of the month methodology	52.712 lead days using the date the product or service is received	43.651 lead days using the date the product or service is received, corrected

Other operations and maintenance expenses include material or services, such as legal services or audit services.⁸² In this context the parties are in dispute over the method of identifying both the beginning and the end point of the lead period. TXU Gas Distribution proposes 32.845 lead days for Other Operations and Maintenance. In calculating the lead days associated with other operating and maintenance expenses, TXU Gas Distribution has employed the midpoint of the month in which the expense is booked as the date to begin computing expense lead days. TXU Gas Distribution proposes to use the actual payment date as endpoint in calculating the relevant lead. The City of Dallas argues that lead days for Other Operating and Maintenance expenses were incorrectly measured. The beginning of the period should be

⁸⁰ The City of Dallas argues in its reply brief that the Commission found in GUD No. 8976 that such amounts should apply across the board. As noted above, the Commission in that case found that neither the applicant nor the intervenors in that case prepared a reliable lead-lag study. Further, the Proposal for Decision in that case did not recommend that such amounts apply across the board. Instead, the Examiner noted that the Applicant in that case failed to measure the expense lead. In this case, the Applicant has accounted for it.

⁸¹ Examiners' Schedule F 4-1, attached to this Proposal for Decision shows the derivation of the lead days associated with pension and benefits, which was based on City of Dallas, Ex. 33, p.7, Schedule B-4.

⁸² TXU Gas Distribution Ex. 20, p. 14 & 17.

measured by the due date on the invoice or the actual payment, whichever is later, and the last possible payment date should be used to measure the endpoint. The City of Dallas recommends 52.712 lead days. The Examiners recommend 43.651 lead days.

i. Applicant's Position

The Applicant initially proposed a 23.183-lead-day level for this expense category.⁸³ The lead day calculation for this group of expenses was based upon random sampling of the non-payroll expenses recorded during the test period. The lead days were calculated from the mid-point of the month in which non-payroll expenses were recorded in the various operations and maintenance accounts until the selected item was paid. Mr. Umbaugh stated that, for those selections paid by check, additional lead days were added for the period between the check date and the date when the check cleared TXU Gas Distribution's bank account. He testified that there are occasions where the goods or services are provided to TXU Gas Distribution in one period and billed to TXU Gas Distribution in an earlier or subsequent period. In those instances, Mr. Umbaugh testified that the recorded date of the transaction cost is the correct date from which service is measured for lead-lag purposes.⁸⁴ Mr. Umbaugh points out that the mid point methodology has been adopted in other jurisdictions.⁸⁵

In response to the argument from the City of Dallas that prepayment represents poor cash management, Mr. Umbaugh argued that the Applicant paid many of those expenses before the final due date to take advantage of discounts that reduce the cost of providing service.⁸⁶ In addition, the payment dates indicated on the invoices are generally the dates by which payments must be received by the supplier. The date on which the Applicant pays the invoice occurs prior to the invoice due date.⁸⁷ He argues that, if the Applicant pays on the due date, TXU Gas Distribution may be subjected to late payment penalties and charges.⁸⁸ Finally, Mr. Umbaugh states that the time and costs required to monitor every invoice payment so that they are paid precisely on the final due date would often exceed the benefit of paying the invoice a few days later even if the precise payment date to avoid penalties could be determined.

In his rebuttal, Mr. Umbaugh notes that he has separated "affiliate other" O&M expenses from "non-affiliate" other O&M expenses to better reflect actual payment patterns. This adjustment increases the number of lead days proposed by TXU Gas Distribution from 23.183 to 32.845.

ii. Intervenor's Position

Mr. Pous argues that the Applicant should have relied upon the date the Applicant received the product or service rather than the mid-point of the month in which non-payroll

⁸³ City of Dallas, Ex. 29, p. 60. Mr. Pous references the Supplemental Direct Testimony Workpapers and/or Relied Upon, Schedule B-2.

⁸⁴ TXU Gas Distribution, Ex. 20, p. 17.

⁸⁵ TXU Gas Distribution, Exhibit 22, p. 12, Exhibit JAU-R-1. Exhibit JAU-R-1 is a copy of the California Standard Practice U-16.

⁸⁶ TXU Gas Distribution, Ex. 22, p. 13.

⁸⁷ *Id*

⁸⁸ *Id*.

expenses were recorded.⁸⁹ He points out that the Public Utility Commission has already addressed the issues raised in this regard. In PUC Docket No. 11375, *Application of Texas Utilities Electric Company for Authority to Change Rates and Investigation of the General Counsel into the Accounting Practices of Texas Utilities Electric Company*, 20 PUC Bulletin 1029, at 1130 (1994), the PUC found that it was reasonable to calculate the operating and maintenance expense lead from the date the goods are received by the utility, rather than the date the utility records the expense.⁹⁰ Mr. Pous alleged that the treatment TXU Gas Distribution employed for measuring service periods for Other Operating and Maintenance expenses is inconsistent with how it measures the service period for revenues and other expenses.⁹¹

He argues that instead of the methodology employed by the Applicant, TXU Gas Distribution should measure the lead days from the date the Applicant received a product or service. Further, in a situation where a vendor allowed a later payment date, the latter date should be recognized in the lead-lag study. Paying before the due date is, according to Mr. Pous, poor cash management.⁹²

iii. Examiners' Analysis and Recommendation

The Examiners agree that paying in advance of the due date represents poor cash management. An analysis of the invoices of the sample selected by TXU Gas Distribution reveals that several payments were made prior to the invoice date, indicating substantial prepayment.⁹³ The lead-lag analysis should reflect that payment was made on the due date indicated on the invoice or the day of the actual payment, whichever is later. The Examiners agree that there should be an allowance for check float, however, the check float was not placed in evidence. Nevertheless, the due date on the invoice is a reasonable estimate.

Further, the Examiners recommend that the date the product or service is received be adopted as the relevant date in calculating the lead days. In order to estimate the date of product or service received, the City of Dallas used the invoice date. The Examiners recommend that the invoice date be adopted as the best estimate of the receipt date instead of mid-point of the month when the transaction was recorded or accrued.

Nevertheless, the lead days recommended by the City of Dallas cannot be applied as proposed by the Intervenor. Mr. Pous did not consider two other components of Other Operations and Maintenance-(1) TUS and TPSRV and (2) Affiliates and Other Affiliates-that were used in the calculations made in Mr. Umbaugh's rebuttal testimony discussed above. By adopting 51.051 lead days as recommended by Mr. Pous, the effects of those two components would be ignored. As presented by TXU Gas Distribution, the lead days applied to Operations and Maintenance were averaged using the lead days for TUS and TPSRV and Affiliates and

⁸⁹ City of Dallas, Ex. 29, p. 60.

⁹⁰ City of Dallas, Ex. 29, p. 61.

⁹¹ Id.

⁹² City of Dallas, Ex. 29, p. 62

⁹³ Compare invoice date on Examiners Exhibit 6, Response to RFI dated September 8, 2000, to the check date on Schedule B-6, Rebuttal Testimony Workpapers and/or Relied Upens, pp. 28-33. A summary of this information is contained in Examiners Schedule F-4-3.

Other Affiliates. Therefore, the City of Dallas' proposed lead days for Third Party Invoices must also be averaged. Table 6.3 summarizes the effect of this recommendation:

Table 6.3

Summary of Other O& M Recommendation

	TXU Gas Distribution ⁹⁴	Examiners' Recommendation
TUS and TPSRV Affiliates	28.792	28.792
Other Affiliates	42.458	42.458
Third Party Invoices	23.183	51.051
Total Other O&M	30.544 ⁹⁵	41.609

e. Revenue-Related Taxes Lead Days

Issue: Should a composite lead day be adopted where an actual lead day is available for revenue related taxes attributable to the Dallas Distribution System?

Examiners' Recommendation: The actual lead days should be used where available.

Applicant	Intervenor	Examiners
20.055 lead days using a lead using a composite	84.745 lead days using actual expense lead days for the DDS	84.704 lead days using actual expense lead days, corrected

TXU Gas Distribution has recommended 20.055 expense lead days for revenue-related taxes.⁹⁶ The lead day calculation for Revenue Related Taxes is composed of three components: Local Gross Receipts Tax, State Franchise Tax, and Taxes Other than Income Taxes. The parties are in not in agreement with the lead days calculated for local gross receipt taxes. The City of Dallas argues that this represents a composite TXU Gas Distribution lead level, rather than one

⁹⁴ TXU Gas Distribution, Ex. 22, Rebuttal Testimony Workpapers and/or Relied Upons, Schedule B-6a.

⁹⁵ This figure is a weighted average and must be derived using the data on Schedule B-6a, TXU Gas Distribution, Ex. 22, Rebuttal Testimony Workpapers and/or Relied Upons.

⁹⁶ TXU Exhibit 22, Rebuttal Testimony Workpapers and/or Relied Upons, Schedule Errata Summary, p. 1.

that is specifically attributable to the Dallas Distribution System. The Intervenor argues that the expense lead day for this category should be based upon the expense leads specifically attributable to the revenue related taxes of the Dallas Distribution System. Therefore, the City of Dallas proposes that revenue related taxes should have an 84.745 expense lead days. The Examiners recommend 84.704 expense lead day.

i. Applicant's Position

In response to the position taken by the City of Dallas, Mr. Umbaugh points out that the City of Dallas only included University Park and Dallas, but excluded Cockrell Hill and Highland Park, even though all four cities are part of this proceeding. Mr. Pous also chose to separately utilize the specific city payment leads for this one cost-of-service component, when all other revenue and expense components are based on averages for the entire system. Mr. Umbaugh argues that this inconsistent approach distorts the results of his analysis of the cash working capital requirement.⁹⁷

ii. Intervenor's Position

The City of Dallas does not agree that a composite sample of the entire system should be used to calculate the expense lead days associated with revenue related taxes. In its Initial Brief, the City of Dallas explains that the Dallas Distribution System has a much longer lead day level than does the composite sample.⁹⁸ The composite sample for TXU Gas Distribution was 20.050 lead days.⁹⁹ As can be seen from Schedule 5.4 the total lead days for Dallas and University Park is 85.191.¹⁰⁰

Table 6.4

Total weighted lead days for Dallas and University Park

Description	Total (Lead)/Lag
Dallas Direct	(90.989)
Dallas Third Party	(91.350)
University Park Direct	133.065
University Park Third Party	(242.244)
Total weighted average	(85.150)

⁹⁷ TXU Gas Distribution Ex. 22, p. 14.

⁹⁸ City of Dallas Initial Brief, p. 12.

⁹⁹ TXU Gas Distribution Ex. 21, Supplemental Direct Testimony Workpapers and/or Relied Upons, Schedule D-5, p. 39.

¹⁰⁰ City of Dallas Ex. 29, Exhibit JP-10.

iii. Examiners' Analysis and Recommendation

The Examiners recommend that the methodology adopted by the Applicant for computing the lead days related to revenue-related taxes be rejected. There is no reason to average the total system-wide lead days with the specific lead days attributable to the Dallas Distribution System. It is logical to develop a composite where costs cannot be specifically linked to the DDS. In the context of directly attributable expense it is not reasonable to use a composite. Actual experience is a more reasonable measure than a composite.

Mr. Umbaugh takes issue with the Intervenor's use of only Dallas and University Park. The Intervenor used the data made available in Mr. Umbaugh's workpapers. This issue was raised in pre-filed testimony and the Applicant had ample opportunity to establish that the weighted average of Cockrell Hill and Highland Park would significantly affect the lead days calculated by the City of Dallas. In addition, Mr. Umbaugh himself did not include Cockrell Hill and Highland Park in his own calculation of a composite.

The Examiners recommend one adjustment to Mr. Pous' calculation. On Exhibit JP-10, explaining his calculation for the revenue related lead days, it is evident that Mr. Pous added the check float twice. The lead days associated with University Park Third Party is indicated as 242.244 days. The Applicant's Schedule D-5 reveals that the lead days for this transaction are 228.500, before a check float is added, and 242.244 after the check float is added. Mr. Pous' exhibit adopted the 242.244 expense lead days and then added the check float to that number. Examiners' Schedule F-4-4 corrects this adjustment. Accordingly, the Examiners recommend an expense lead day of 84.704.

f. Current Federal Income Taxes Lead Days

Issue: Should the FIT expense lead day calculated for TXU LSP in GUD No. 8976 be adopted for TXU Gas Distribution?

Examiners' Recommendation: TXU Gas distribution has established that it reasonably calculated the expense lead days for FIT.

Applicant	Intervenor	Examiners
37 lead days based on TXU Gas Distribution data	85.407 lead days based on TXU LSP lead days in GUD No. 8976	37 lead days

The Applicant has proposed a 37-expense-lead-day level for federal income taxes (FIT). The Intervenor recommends adoption of the expense lead days proposed by the intervenors for TXU LSP in GUD No. 8976 of 85.407 days. The Examiners recommend 37 days.

i. Applicant's Position

Mr. Umbaugh explained that the lead time was calculated by measuring the days between the mid-point of an annual calendar year service period and the actual FIT payment dates of TXU Gas Distribution. Payment of at least 100% of the estimated tax for the year must be made in quarterly payments on April 15th, June 15th, September 15th, and December 15th. He concluded that these quarterly payments, made on the indicated dates, produce the 37.00-lead-day level.¹⁰¹

In response to issues raised by the City of Dallas, Mr. Umbaugh argues that Mr. Pous improperly used lead days developed for TXU Lone Star Pipeline in GUD No. 8976 and applied them in this docket. He argues that Mr. Pous relies on incomplete stand-alone tax data for TXU LSP rather than complete stand alone tax data for TXU Gas Distribution. Finally, he points out that Mr. Pous has used 1998 tax information, rather than information updated for 1999.¹⁰²

ii. Intervenor's Position

Mr. Pous argues that the Applicant's figures are based on four estimated payment dates assuming equal amounts paid for each of the four payments. He argues that the Applicant's use of a hypothetical amount for each payment in its calculation of lead days is inappropriate. He notes that, in GUD No. 8976, the Commission found that a similar proposal made by TXU Lone Star Pipeline, an unincorporated affiliate of TXU Gas Distribution, failed to "measure the time between when TXU LSP incurred federal income tax liability and when the tax liability was paid."¹⁰³ He argues that the 85.407 lead day period calculated in that case should be adopted here because TXU LSP and TXU Gas Distribution are affiliates of the same parent company.

iii. Examiners' Analysis and Recommendation

The Examiners recommend that the lead days proposed by the Applicant be adopted. The Intervenor has not demonstrated that the expense lead calculation of the Applicant resulted in an unreasonable calculation. The Intervenor relies on calculations developed in GUD No. 8976 regarding a different entity. Indeed, Mr. Pous admitted that he was not aware whether TXU LSP and TXU Gas Distribution had equivalent tax payments. The City of Dallas' reliance on Finding of Fact No. 70 in the Final Order issued in GUD No. 8976 is misplaced. That finding stated specifically that TXU LSP failed to "measure the time between when TXU LSP incurred federal income tax liability and when the tax liability was paid."¹⁰⁴ The Intervenor in that case established that fact. The Intervenor failed to establish the same fact in this case. Information specific to TXU Gas Distribution should be used. Finally, the Examiners note that Mr. Umbaugh stated that 37 payment lead days based on statutory payment dates is often used for federal income tax expenses as an estimate of normal payment patterns.¹⁰⁵

¹⁰¹ TXU Gas Distribution, Ex. 23, p. 18.

¹⁰² TXU Gas Distribution, Ex. 22, p. 14.

¹⁰³ GUD No. 8976, FOF 70.

¹⁰⁴ Id.

¹⁰⁵ TXU Gas Distribution, Ex. 22, p. 15.

g. Depreciation Expense, Return on Common Equity, and Deferred Federal Income Taxes

TXU Gas Distribution has not proposed a cash basis lead-lag study. The City of Dallas

Issue: Should non-cash expenses be included in the cash working capital analysis?

Examiners' Recommendation: Non-cash expenses should not be included in the cash working capital analysis.

Applicant	Intervenor	Examiners
FIT-Deferred-\$58,307	FIT-Deferred-\$0	FIT-Deferred-\$0
Return-(\$74,997)	Return-\$0	Return-\$0
Depreciation-\$600,476	Depreciation-\$0	Depreciation-\$0

argues that it is fundamental error to conduct a lead-lag study that is not performed on a cash basis.¹⁰⁶

i. Applicant's Position

In its reply brief, TXU Gas Distribution argues that the Commission has not adopted a rule setting forth how a cash working capital analysis should be performed.¹⁰⁷ Consequently, the standards applicable to a cash working capital analysis must be evaluated on a case-by-case basis. Mr. Umbaugh argued that depreciation expense, deferred income tax expense, and return on common equity are significant cost of service items that are necessarily included in determining comprehensive cash working capital allowances.¹⁰⁸ He disagrees with the notion that these "non-cash" items should be excluded from the cash working capital determination because they do not require the current outlay of cash. On the contrary, Mr. Umbaugh argues that these items must be included as virtually all utility revenue or expense is recorded before or after the actual cash receipt or disbursement.

Indeed, very few, if any, revenue or expense items are recorded when the cash is received or disbursed. The recording of these expenses results in a like amount being recorded in the offsetting balance sheet account.¹⁰⁹

ii. Intervenor's Position

The Intervenor argues that non-cash items have been excluded from an analysis of cash working capital in the past. Mr. Pous testified that the PUC rules also require that only cash items be included in the cash working capital analysis.¹¹⁰

¹⁰⁶ TXU Gas Distribution, Ex. 29, p. 54.

¹⁰⁷ TXU Gas Distribution, Reply Brief, 69.

¹⁰⁸ TXU Gas Distribution, Ex. 20, p. 8.

¹⁰⁹ TXU Gas Distribution, Exhibit 20, p. 19.

¹¹⁰ City of Dallas, Exhibit 29, p. 54.

iii. Examiners' Analysis and Recommendation

In the past, the Commission has excluded non-cash expenses, such as depreciation and return, from calculation of the cash working capital analysis.¹¹¹ This determination is consistent with the treatment of cash working capital in other jurisdictions.¹¹² Mr. Pous recommends that the Commission continue the standard practice of relying on a cash basis lead-lag study to determine working capital requirements and the Examiners agree with that recommendation. Therefore, non-cash expenses should not be included in the cash working capital analysis.

h. Average Daily Bank Balances

i. Applicant's Position

Issue: Should a cash allowance be permitted for average daily bank balances?		
Examiners' Recommendation: No. Ratepayers should not be required to compensate shareholders for interest on funds that they did not provide.		
Applicant	Intervenor	Examiners
Average Daily Bank Bal. \$276,031	Average Daily Bank Bal. \$0	Average Daily Bank Bal. \$0

Mr. Umbaugh testified that TXU Gas Distribution's lead-lag study reflected cash receipts float on deposits as an addition to the revenue lead days, and check float on disbursements is added to all expenses paid by check to reduce cash working capital. Because TXU Gas Distribution cannot control when deposits and checks will clear the bank and because of other minimum balance requirements imposed by banks, TXU Gas Distribution must maintain certain levels of available cash in its bank accounts. Therefore, the actual bank cash balances are included in the cash working capital since these funds must be supported by investors¹¹³.

He points out that these cash balances were determined from bank statements containing daily balances maintained in each of TXU Gas Distribution's bank accounts. These daily balances were averaged over the test year for each of the banks, and the \$276,031 amount assigned to the Dallas Distribution System as total present revenues compared to TXU Gas Distribution total revenues per books for the twelve-month period ended September 30, 1999.¹¹⁴

In response to Mr. Pous' argument that ratepayers have provided the average investment in bank balances rather than investors, Mr. Umbaugh argues that this is based on the unsubstantiated belief that these amounts represent ratepayer-supplied funds. He argues that Mr.

¹¹¹ FOF 67 & 68, GUD No. 8976, *Statement of Intent to Change the City-Gate Rate of TXU Lone Star Pipeline, Formerly Known as Lone Star Pipeline Company Established in GUD No. 8664* (2000).

¹¹² Tex. Admin. Code § 23.21 (West 2000); Re U.S. West Communications, Inc., 152 PUR 4th (Iowa UB, 1994) (Iowa Utilities Board agreed that depreciation, deferred income taxes were non-cash items that should not be included in the cash working capital analysis.)

¹¹³ TXU Gas Distribution, Exhibit 20, p. 23 & TXU Gas Distribution, Exhibit 22, p. 17.

¹¹⁴ *Id.*

Pous' proposal reflect a significant misunderstanding of the purpose of the lead-lag study should measure cash working capital. The lead-lag study should identify all of the utility's requirements for capital that have not otherwise been included as separate rate base components and to similarly identify any cost-free or non-investor-supplied sources of capital that have not been either included as separate rate base components or included in the capital structure.¹¹⁵

Finally, he points out that Mr. Pous has selectively relied on Public Utility Commission rules. Whereas in the context of non-cash items the PUC has a specific rule which supports Mr. Pous' position, in this context the PUC rules contradicts the position taken by the Intervenor. Specifically, PUC Substantive Rule 25.231(c)(2)(B)(iii)(IV)(e) states that “. . . the balance of cash and working funds included in the working cash allowance calculation shall consist of the average daily bank balances of all non-interest bearing demand deposits and working cash funds.”¹¹⁶

ii. Intervenor's Position

Mr. Pous argues that adoption of the Applicant's request will result in double charging customers for the same expense. He alleges that the double counting occurs since ratepayers are already providing the day-to-day cash working capital requirements of TXU Gas Distribution. The Applicant is, in effect, using cash provided by ratepayers to fund its average daily bank balances. To provide the Applicant a return on this amount would require ratepayers to pay the Applicant a return on ratepayer-provided funds.¹¹⁷

He points out that this Commission has previously addressed this issue. In GUD No. 8878, *Appeal of Southern Union Gas Company from the Actions of the City of El Paso*, (November 18, 1998) the Commission rejected the same request. Moreover, in GUD No. 8976, *Statement of Intent to Change the City-Gate Rate of TXU Lone Star Pipeline, Formerly Known as Lone Star Pipeline Company, Established in GUD 8664* (June 22, 2000), the Commission ruled that average bank balances should be excluded from the cash working capital allowance.¹¹⁸

iii. Examiners' Analysis and Recommendation

The Examiners recommend that TXU Gas Distribution's request for a cash allowance for average daily bank balances be rejected. The Commission has rejected similar requests in GUD No. 8878 and GUD No. 8976. The Examiners agree with the Intervenor, and the finding in GUD No. 8878, that ratepayers should not be required to compensate shareholders for interest on funds they were not asked to provide.¹¹⁹ Mr. Umbaugh has not substantiated his claim that, even if the remainder of the lead-lag study produces a negative cash working capital requirement, there is still an investment requirement in average bank balances that reduces the net cash working capital that is provided by ratepayers.¹²⁰ The fact that a substantial negative cash working capital

¹¹⁵ TXU Gas Distribution, Ex. 22, p. 18.

¹¹⁶ *Id.*

¹¹⁷ City of Dallas, Ex. 29, p. 65.

¹¹⁸ *Id.*

¹¹⁹ GUD No. 8878, FOF 120.

¹²⁰ TXU Gas Distribution, Ex. 22, p. 18.

exists must necessarily imply that the bank balances are provided through those funds, which were made available by ratepayers.

i. Working Funds and Other Lead Days

Issue: Should sales taxes be removed from the calculation of Working Funds and Other?		
Examiners' Recommendation: Yes. Sales taxes should be removed from Working Funds and Other. The Intervenor has not established that a credit should be made to this amount due to pre-payment benefits.		
Applicant	Intervenor	Examiners
Working funds (\$4,756)	Working funds (\$316,810)	Working funds (\$4,756)

In addition to the components of cash working capital already discussed, the Applicant had included a cash working capital component for working funds, sales tax collections, payroll withholding, miscellaneous deferred debits and credits, and other accounts receivable.¹²¹ In rebuttal testimony, the Applicant removed all amounts associated with sales tax collections.¹²²

i. Applicant's position

These items represent levels of investor capital that are required to fund various assets not explicitly identified in the rate base, as well as deductions for non-investor sources of capital not explicitly deducted from rate base. They are not, however, directly measured in the analysis of O&M expenses and must be separately included in the cash working capital measure.¹²³ The Applicant removed all amounts associated with sales tax collections as TXU Gas Distribution does not include the discount for prepayment as a credit to the cost of service.¹²⁴

ii. Intervenor's Position

Mr. Pous testified that the majority of the Applicant's request is based on sales tax collection and the request reflects a prepayment of sales tax. He argues that the normal payment pattern for sales tax collection is not a prepayment but rather payment by the twentieth day of the month following a calendar quarter. He notes that a prepayment is available if a company seeks a discount in the level of sales tax to be paid. However, the Applicant appears to seek a discount for the benefit of shareholders while seeking a penalty for customers by claiming a pre-payment

¹²¹ TXU Gas Distribution, Exhibit 20, p. 24.

¹²² TXU Gas Distribution, Exhibit 22, p. 19.

¹²³ TXU Gas Distribution, Exhibit 20, p. 24.

¹²⁴ TXU Gas Distribution, Exhibit 22, p. 19.

in the lead-lag study.¹²⁵ The Intervenor argues, however, that the adjustment should be made to reflect the benefit of tax prepayments.

iii. Examiners' Analysis and Recommendation

The Examiners recommend that TXU Gas Distribution's proposed cash working capital request for Working Funds and Other be adopted. The Applicant has removed the sales tax collection from its original request and has established its burden of showing that the funds available in working funds and other accurately measure the day-to-day needs of this account.

VII. Rate of Return

Issue: What is the appropriate rate of return for TXU Gas Distribution?		
Examiners' Recommendation: The rate of return, based on a 12.1% cost of equity, should be set at 9.75%.		
Applicant	Intervenor	Examiners
9.82 % rate of return based upon 12.25% cost of equity	9.13% rate of return based upon 10.9% cost of equity	9.75% rate of return based upon 12.1% cost of equity

As part of this proceeding the Commission must establish a reasonable rate of return for the Applicant. In establishing a gas utility's rates, the regulatory authority shall establish the utility's overall revenues at an amount that will permit the utility a reasonable opportunity to earn a reasonable return on the utility's invested capital used and useful in providing service to the public in excess of its reasonable and necessary operating expenses.¹²⁶ The regulatory authority may not establish a rate that yields more than a fair return on the adjusted value of the invested capital used and useful in providing service to the public.¹²⁷

A utility's return on its investment is a product of the rate base multiplied by a fair rate of return.¹²⁸ Thus, having established a rate base, the next task for the Commission is to determine a suitable rate of return.¹²⁹ The rate of return is the amount of money that a utility is allowed an opportunity to earn, over and above operating expenses, depreciation and taxes.¹³⁰ As noted by the Austin Court of Appeals in *Railroad Commission of Texas v. Lone Star Gas Company*, to achieve the rate of return that a utility should be allowed to earn, the regulatory agency should

¹²⁵ City of Dallas, Exhibit 29, p. 66.

¹²⁶ TUC § 104.051.

¹²⁷ TUC § 104.052.

¹²⁸ *Railroad Commission of Texas v. Lone Star Gas Company*, 599 S.W.2d 659 (Tex. App.—Austin 1980).

¹²⁹ *Id.*

¹³⁰ *Id.*

consider the cost to the utility of its capital expressed as follows: (1) interest on long-term debt; (2) dividends on preferred stock; and (3) earnings on common stock.¹³¹

The first step in determining an appropriate rate of return for TXU Gas Distribution is calculating its capital structure. Each of the elements of the capital structure of the utility is given a weighting based upon its contribution to the company's capital structure to arrive at a composite rate of return.¹³² In order to develop an appropriate capital structure and cost, analysis of market data for the company is usually analyzed. However, TXU Gas Distribution, the focus of this case, is not traded in the market. All of the Applicant's shares are owned by the parent company, TXU Corporation, where the primary focus is the electric utility. All parties agreed that a proxy for TXU Gas Distribution could be used. Dr. Fairchild and Mr. Lawton used a group of twelve publicly traded LDC's:

1. AGL Resources, Inc.
2. Atmos Energy Corporation
3. Cascade Natural Gas
4. Laclede Gas
5. NUI Corporation
6. New Jersey Resources
7. NICOR, Inc.
8. Peoples Energy Corporation
9. Piedmont Natural Gas
10. SEMCO ENERGY
11. South Jersey Industries
12. Washington Gas

Based on an analysis of the capital structure of the proxy group, all parties in this case agree to a capital structure for the Applicant as follows: 47.1 percent long term debt, 1.7 percent preferred stock, and 51.2 percent common equity.¹³³ The parties also agree that the cost of debt should be 7.24% and the cost of preferred stock should be 5.54%.¹³⁴ The parties are not in agreement as to the cost of equity.

A. Applicant's Position

TXU Gas Distribution has requested an overall rate of return of 9.82%. The Applicant's rate of return recommendation was presented by TXU Gas Distribution witness Dr. Bruce Fairchild. Dr. Fairchild points out that, unlike debt capital, there is no contractually guaranteed return on common equity capital as shareholders are the residual owners of the utility. Nonetheless, common equity investors still require a return on their investment, with the cost of equity being the minimum "rent" that must be paid for the use of their money. The cost of equity serves as the starting point for determining a fair rate of return.¹³⁵

¹³¹ *Id*

¹³² *Id.*

¹³³ City of Dallas, Ex. 28, p. 25; Tr Vol. 4, p. 86.

¹³⁴ City of Dallas, Ex. 28, p. 18; Tr Vol. 4, p. 86.

¹³⁵ TXU Gas Distribution, Ex. 23, p. 23.

Dr. Fairchild's recommended rate of return on common equity was selected from a cost of equity range of 11.75 percent to 12.75 percent that was based on the result of two analysis—the constant growth discounted cash flow (DCF) analysis and a risk premium analysis. The DCF analysis produced a cost-of-equity range of 11.65 percent to 12.65 percent. The risk premium analysis produced a cost of equity range of 11.8 percent to 13.1 percent.¹³⁶

Table 7.1 is a summary of the analysis conducted by the Applicant's witness. Column A is the Capital Structure: Debt, Preferred Stock, and Common Equity. Column B is the cost or rate of return associated with each element of the capital structure. Finally, Column C is the method applied by the Applicant's witness in calculating the cost or rate of return required for each element of the capital structure.

Table 7.1

<i>Column A</i>	<i>Column B</i>	<i>Column C</i>
Capital Structure	Cost/Rate of Return	Method for calculating Cost/Rate of Return
Debt	7.34 %	Average Cost of Long Term Debt of LDC Group
Preferred Stock	5.54%	Average Cost of Preferred Stock of LDC Group
Common Equity	12.25%	1. DCF: 11.65%-12.65% 2. Risk Premium Analysis: 11.8%-13.1%

Dr. Fairchild states that there are two basic steps in implementing the constant growth DCF model. The first step is to determine the expected dividend yield and the second step is to estimate investors' long-term growth expectations.¹³⁷ In order to calculate the dividend yield component of the constant growth DCF model for the LDC industry group, Dr. Fairchild examined Value Line's estimate of dividends to be paid by each LDC over a period of twelve months, obtained from the index to its March 24, 2000 edition.¹³⁸ The average dividend yield calculated by Dr. Fairchild for the LDC group was 5.9 percent.

Next, Dr. Fairchild calculated investor's long-term growth expectations. Dr. Fairchild analyzed the historical trends for the twelve LDCs, applied an earnings retention analysis, and examined investment advisory services. This analysis produced a range of possible results. Dr. Fairchild undertook to remove all implausible results. After eliminating growth rates that failed fundamental economic tests of reasonableness, the remaining plausible growth rate ranged between 5.2 and 7.3 percent.¹³⁹ The range was then modified from 5.75 to 6.75 percent which, when combined with the group's average dividend yield of 5.9 percent, produced a DCF cost of equity range for the LDC industry group between approximately 11.65 and 12.65 percent.¹⁴⁰

¹³⁶ TXU LSP Ex. 13, p. 7.

¹³⁷ TXU Gas Distribution, Ex. 23, p. 31.

¹³⁸ TXU Gas Distribution, Ex. 23, p. 32.

¹³⁹ TXU Gas Distribution, Ex. 23, p. 40.

¹⁴⁰ Id. Dr. Fairchild does not elaborate in his testimony on how the range was modified.

Dr. Fairchild also conducted a risk premium analysis in order to calculate a predicted growth rate.¹⁴¹ The risk premium analysis resulted in a cost of equity range between 11.8 percent and 13.1 percent. Using the ranges produced by the DCF analysis and the risk premium analysis, Dr. Fairchild concluded that the appropriate common equity range was 11.75 percent to 12.75 percent. He arrived at his cost of equity recommendation by selecting the midpoint of that range, *i.e.* 12.25 percent.

B. Intervenor's Position

In conducting his DCF analysis, Mr. Lawton agreed that the return received by the investor over the holding period is composed of (i) dividend payments, and (ii) appreciated sale value of the investment.¹⁴² The City of Dallas is also in agreement that the dividend yield is the ratio of the dividend rate to the stock price.¹⁴³ Mr. Lawton argues that one should not rely on spot market prices for a particular stock, nor should one rely on long periods of time or unrepresentative data. After examining data for recent price periods, Mr. Lawton concluded that a dividend yield should be based on a review of six weeks of market prices.

Mr. Lawton examined three measures of growth rates to estimate the expected growth rate. First, Mr. Lawton examined the growth in Value Line historical five and ten year growth rates for book value, earnings and dividends per share. He also examined the Zacks earnings estimates for each company. Finally, he examined the set of growth rates for Value Line forecast earnings, dividends and book-value-per-share growth rates.¹⁴⁴ He developed a growth rate range of 4.78% to 6.24%. Further analysis resulted in a cost of equity range from 10.25 percent to 11.62 percent. Mr. Lawton selected the midpoint of the range and recommended a return on equity of 10.9%

C. Examiners' analysis and recommendation

TXU Gas Distribution used a reasonable time period for calculating the dividend rate per stock. The City of Dallas failed to establish that the approach used by Mr. Fairchild, analyzing twelve months worth of data, was unreasonable. Mr. Lawton does not explain his conclusion that six weeks is an adequate period for calculating the dividend. The Examiners agree that the use of a very short time period is unreasonable for calculating the dividend rate per stock. Therefore, the Examiners recommend a dividend yield of 5.9 percent.

The Examiners recommend that the predicted growth rate range for common equity be between 5.2 and 7.3 percent. Dr. Fairchild made two unexplained adjustments in his analysis. First, after stating that the plausible growth rates ranged between 5.2 and 7.3 percent, Dr. Fairchild made an adjustment and determined that the reasonable range was 5.75 to 6.75. No explanation for this adjustment was provided. Adding a 5.9 dividend yield rate to Dr. Fairchild's of 11.1 percent and 13.2 percent. The midpoint of this range is 12.1 percent original growth rate range-5.2 percent to 7.3 percent-results in a DCF range for common equity.

¹⁴¹ TXU Gas Distribution, Ex. 23, pp. 41-53.

¹⁴² City of Dallas, Ex. 28, p. 20.

¹⁴³ City of Dallas, Ex. 28, p. 21.

¹⁴⁴ City of Dallas, Ex. 28, p. 22.

The second adjustment occurred after Dr. Fairchild establishes a range of reasonableness of 11.8 percent to 13.1 percent of using the risk premium analysis. After concluding that the DCF range was 11.65 percent to 12.65 percent, he presumably used the results of his risk premium analysis to raise the range to 11.75 percent to 12.75 percent. In its Initial Brief, the Applicant states that the Examiners in GUD No. 8664 found that the risk premium method is a valid means to confirm a DCF analysis. However, there is no indication that an adjustment needs to be made. The risk premium analysis confirms that a 12.1 percent return on equity is reasonable.

VIII. Revenues and Regulatory Expenses

A. Revenues

Issue: Should the cost of service requested in this case be offset by profits related to the sale of land owned by TXU Gas Distribution?

Examiners' Recommendation: No. Pursuant to the criteria set forth in *Gulf States* the Intervenor has not established that ratepayers have borne any risks associated with the property.

Applicant	Intervenor	Examiners
No adjustment.	\$1,220,658 adjustment through an annual amortization of \$406,886	No adjustment. Record does not reflect that ratepayers have paid for any portion of the property

1. Gain on Sale of Assets

Since 1994, TXU Gas Distribution has sold forty-two separate assets. The Applicant reported that it realized a net profit of \$3,219,341 on the sale of land related to a portion of these assets. All of the profits from the sale of land have been retained for the shareholders of TXU Corp. The City of Dallas argues that a portion of these profits should be assigned to ratepayers.

a. Applicant's position

Mr. Florence testified that ratepayers received the benefit of the utility service provided by the land and the facilities on that property. In return, the ratepayers paid the cost of service associated with the Applicant's ownership of the land. However, the shareholders of TXU Gas Distribution undertook the financial risk associated with the ownership of the land. It was the

shareholders who provided the funds to purchase the land. Further, he notes that land is not a depreciable asset. Therefore, investors have not received any depreciation expense associated with the land. As a result, the ratepayers have no claim on any gain or loss resulting from the sale of the land.¹⁴⁵ Dane Watson, the Applicant's witness, adds that all of the sales that are the subject of the Intervenor's proposed adjustment occurred outside of the test year.¹⁴⁶

In its Initial Brief, the Applicant argues that it has properly treated the gain on sale of land. Specifically, NARUC requires TXU Gas Distribution to book gains or losses associated with land sales in Account 421 or 422.¹⁴⁷ The Applicant argues that the Intervenor's proposal to book gains or losses in Account 108 flatly contradicts NARUC's mandate. The Applicant points out that the Intervenor's own counsel acknowledged during the hearing that he understood that "ratepayers may not have paid for the land because there was no depreciation."¹⁴⁸ Finally, the Applicant points out that the Supreme Court has noted that an allocation of the gain from the sale of plant must be governed by the equitable principles that "benefits should follow burdens" and that "gain should follow risk of loss."¹⁴⁹ The Applicant concludes that there has been no showing that the ratepayers have borne any of the risk associated with the sale of land and such a showing must be made prior to the allocation of any gain related to the sale. Thus, the standard enunciated by the Supreme Court in the *Gulf States* case has not been met.¹⁵⁰

b. Intervenor's position

Mr. Pous points out that generally the gain or loss associated with the sale of an asset is booked to the Accumulated Provision for Depreciation ("Account 108"). TXU Gas Distribution does not book the gain or loss on the sale of land to that account. The gain or loss on land is transferred from Account 108 to Accounts 421.1 or 421.2, respectively. Mr. Pous argues that the gain or loss of sale of plant should remain in Account 108. He points out that TXU Gas Distribution has sold forty-two separate assets since the end of 1994. Those sales have resulted in a net profit to the Applicant of \$3,219,341.¹⁵¹

The result, he argues, is that all profits are retained for the benefit of shareholders. Mr. Pous argues that ratepayers have paid a return on the investment the Applicant made for land purchases. In addition, customers have also paid property taxes and upkeep on utility land. He proposes that the ratepayers of the Dallas Distribution System be allocated a portion of the profits. Of the total net profits, \$806,920 is directly attributable to property sold in the Dallas Distribution Service area. The remainder, \$2,412,762.94, should be allocated to the Dallas Distribution System based on the proportion of DDS customers to total TXU Gas Distribution

¹⁴⁵ TXU Gas Distribution, Ex. 41, p. 11.

¹⁴⁶ TXU Gas Distribution, Ex. 47, p. 42.

¹⁴⁷ Rules adopted by the Railroad Commission of Texas require utilities to follow the NARUC system of accounts. 16 Tex. Admin. Code § 7.43 (Providing that "each gas utility . . . shall utilize the National Association of Regulatory Utility Commissioners' (NARUC Uniform System of Accounts for Class A and B Utilities (1976 edition or as subsequently amended) for all operating and reporting purposes.)

¹⁴⁸ Tr. Vol. 7, p. 1.

¹⁴⁹ *Public Util. Comm'n of Texas v. Gulf States Utilities Co.*, 809 S.W.2d 201 (Tex. 1991) (*Gulf States*).

¹⁵⁰ TXU Gas Distribution, Initial Brief, p. 75.

¹⁵¹ City of Dallas, Ex. 29, pp. 75-77.

customers.¹⁵² That allocation factor is 17.1479%.¹⁵³ He proposes that a total of \$1,220,658 be returned to the ratepayers through an annual amortized amount of \$406,886.¹⁵⁴

c. Examiners' analysis and recommendation

The Examiners recommend that the Intervenor's proposed adjustment be rejected. The Applicant has properly booked the gain, or loss, on the asset sales. In *Gulf States*, the Supreme Court held that gains should be allocated to that group (as between shareholders and ratepayers) that has "borne the financial burdens (e.g., depreciation, maintenance, taxes) and risks of the asset sold."¹⁵⁵ The Court enumerated several other factors that may be considered: (1) whether the asset has been included in rate base over the years; (2) whether the asset is depreciable property; (3) the impact of the proposed allocation on the financial strength of the utility; (4) the reason for the asset's appreciation; (5) any advantages enjoyed by the shareholders because of the favored treatment accorded the asset; and (6) any extraordinary burdens borne by the ratepayers in connection with the asset. The City of Dallas has not established a record with regards to these factors. Indeed, the non-depreciable nature of the asset would suggest that the ratepayers have not borne any risks. Finally, the Examiners recommend rejecting the proposed adjustment because all of the property in question was sold outside of the test year.

2. Rate Case Weather Normalization Adjustment

Issue: Should the base load for calculating the weather normalization adjustment be determined using the base load over the period of June 1999 through September 1999 or the base load of a single month?

Examiners' Recommendation: As described in the Railroad Commission's Natural Gas Rate review handbook, base load is correctly calculated using those months in which no heating degree days occurred.

Applicant	Intervenor	Examiners
No adjustment.	\$439,834 increase in present base rate revenues	No adjustment: Record reflects that the base load was correctly calculated

¹⁵² City of Dallas, Ex. 29, Exhibit JP-14.

¹⁵³ City of Dallas, Ex. 29, Exhibit JP-14, line 44 & TXU Gas Distribution, Revised Exhibit 4, Cost of Service Exhibits, p. 7-9.

¹⁵⁴ City of Dallas, Ex. 29, Exhibit JP-14. On that exhibit, Mr. Pous describes his calculation for this adjustment. However, in his testimony, Mr. Pous states that his recommendation results in a \$453,009 annual reduction to revenue requirements and a \$1,359,028 reduction to rate base. City of Dallas, Ex. 29, p. 77. There is no explanation or underlying support in the record for the figures stated in his testimony.

¹⁵⁵ *Gulf States* at 211.

Mr. Florence testified that three adjustments were made to residential and commercial sales volumes. The first adjustment was to adjust the sales volumes to the level for the twelve months ended December 31, 1999. The second adjustment was to weather normalize the residential and commercial sales volumes. The third adjustment was to adjust the sales volumes to reflect the change in the number of customers.¹⁵⁶ The City of Dallas has challenged the Applicant's adjustment to weather normalize the residential and commercial sales volumes.

a. Applicant's Position

In response to arguments by the City of Dallas that the weather normalization adjustment was incorrectly calculated, Mr. Florence points out that the only difference is that the Applicant based its calculation of base load on consumption over the period of June 1999 through September 1999 and the Intervenor bases its calculation of base load on the single month of August 1999.¹⁵⁷ He argues that the use of a single month fails to recognize the impact of customers either leaving the system or coming onto the system over the summer months. It also fails to adequately recognize periods of non-use, such as when customers are away for vacation. He points out that the goal is to determine the average base load of the residential and commercial customers. Analyzing consumption data for those classes of customers over the months in which there is no heating load accomplishes this goal. He concludes that the use of multiple months will result in a true measure of base load and will reflect the fact that the class base load may change somewhat from month to month over the summer months as the customer mix changes. Finally, Mr. Florence points out that this methodology has been applied in prior Commission cases and is specifically recognized in the Commission's Natural Gas Rate Review Handbook.

b. Intervenor's position

Mr. Pous testified that the weather normalization adjustment proposed by the Applicant had been incorrectly calculated. Mr. Pous argues that the Applicant has assumed that the usage level during the four-month period of June through September represents the non-heating load for the Residential and Commercial classes. He argues that by using the four summer months as the non-heating base period rather than the month with the lowest use per customer, August, the Applicant "understates the weather sensitive load."¹⁵⁸ In order to more appropriately estimate the non-heating load for the Residential and Commercial classes, only the month of August should be relied on for the non-heating base period for the weather normalization calculation.¹⁵⁹

c. Examiners' Analysis and Recommendation

The Examiners agree that the Applicant has correctly calculated the weather normalization adjustment (WNA). The Applicant has followed the recommendation in the

¹⁵⁶ TXU Gas Distribution Ex. 26, p. 12.

¹⁵⁷ TXU Gas Distribution Ex. 41, p. 6. TXU Gas Distribution's Initial Brief argues that Mr. Pous' testimony and the testimony of Mr. Lawton contradict each other on the issue of weather normalization. The Examiners do not agree and point out that Mr. Lawton's testimony was directed at the issue of weather normalization adjustment clauses in rate design and ultimately the tariff proposed by TXU Gas Distribution. On the other hand, Mr. Pous' testimony is directed at the issue of rate case weather normalization of test year revenues.

¹⁵⁸ City of Dallas, Ex. 30, p. 69.

¹⁵⁹ Id.

Natural Gas Rate Review Handbook by including all months in which no heating degree-days occurred.¹⁶⁰ Based on the testimony in the record, TXU Gas Distribution has used a similar methodology in calculating the weather normalization adjustment since 1985.¹⁶¹

3. Consumption Pattern Normalization Adjustment

Issue: Should the test year consumption statistics be adjusted to reflect that consumption patterns are not uniformly declining from year to year?

Examiners' Recommendation: No. Consumption statistics should be based on test year patterns.

Applicant	Intervenor	Examiners
No adjustment	\$637,194 in additional base rate revenues due to a consumption normalization adjustment	No adjustment: Consumption should be based upon test year measures.

The Intervenor argues that the adjusted level of present base revenues for the residential and commercial classes proposed by TXU Gas Distribution are approximately two percent lower than the level of present base rate revenues filed by the Applicant at the city level. The City of Dallas argues that this reduction should be adjusted.¹⁶²

a. Applicant's Position

The Applicant argues that the reduced consumption is a consistently declining trend. The trend is due to ongoing gains in space heating efficiency, ongoing gains in water heating efficiency, and ongoing gains in residential energy efficiency through improved insulation and the use of storm doors and windows. Additional reductions could be attributable to a reduction in the number of gas appliances per customers.¹⁶³

The actual consumption per customer for the test year reflects the consumption patterns of the customers during the test year. There is no indication that they are abnormal and need

¹⁶⁰ Natural Gas Rate Review Handbook, p. 45.

¹⁶¹ He argues the TXU Gas Distribution calculated the weather normalization adjustment using the same technique in the following cases: *Appeal of Lone Star Gas Company from the Action of the City of Pflugerville, Texas*, GUD No. 5484 (09, 16, 1985); *Appeal of Lone Star Gas Company from the Action of the City of Sulphur Springs, Texas, and Statement of Intent to Increase Residential and Commercial Rates in the Environs of the City of Sulphur Springs*, GUD Nos. 6344 & 6345 (May 18, 1987); *Appeal of Lone Star Gas Company from the Action of the City of Stephenville, Texas*, GUD No. 7269 (September 7, 1989); *Appeal of Lone Star Gas Company from the Action of the City of Sonora, Texas*, GUD No. 7325 (October 20, 1989); *Appeal of Lone Star Gas Company from the Action of the City of Wellington, Texas*, GUD No. 7829 (January 28, 1991).

¹⁶² City of Dallas, Initial Brief, p. 22.

¹⁶³ City of Dallas, Ex. 29, p. 71, quoting from Applicant's response to RFI 7-7.

adjustment. While Mr. Florence agrees with Mr. Pous' assertion that consumption per customer will vary over time as customers with different consumption patterns enter and leave the system, Mr. Florence argues that there exists a distinctive downward trend in the pattern of consumption. This trend is due primarily to new technologies. In addition, he examines the same data that Mr. Pous used and concludes that the data supports the hypothesis that the direction of the changes in consumption pattern are predominantly downward. Mr. Florence argues that the only way to rationalize the proposal made by the Intervenor is to assume that in the future, consumption per customer will reverse itself and begin to increase. The City of Dallas, he argues, has offered no support for this hypothesis. Finally, Mr. Florence notes that a report published by the American Gas Association discusses the ongoing decline in residential consumption per customer.¹⁶⁴

b. Intervenor's Position

The City of Dallas takes issue with TXU Gas Distribution's argument that a decline in weather-normalized consumption per customer represent all of the reasons for the decline. He argues that the 4% reduction in present base rate revenues has occurred with a reduction of 1,097 residential and commercial customers. He calculates that this represents less than a 0.5% reduction in the number of residential and commercial customers. He concludes that the reduction in the number of customers obviously does not provide the basis for diminishing base rate revenues.¹⁶⁵

He argues that the reason for the diminishing base rate revenues is due to changes in the consumption pattern per customer. There are always normal variations in usage patterns from year to year. Such variations may be due to a number of factors that can and do cause the consumption per customer to vary from year to year. A number of such factors include, but are not limited to, changes in efficiency of gas consumption appliances, changes in the weatherization condition of homes and buildings, the amount of vacation taken by customers, the number of visitors and how long they stay in the service territory. He concludes that these changes should be adjusted through a use of a consumption normalization adjustment.¹⁶⁶ Mr. Pous does not believe that there is a trend towards reduced consumption. Table 8.1 summarizes the statistics gathered by the City of Dallas.

¹⁶⁴ TXU Gas Distribution, Ex. 41, p. 8.

¹⁶⁵ City of Dallas, Ex. 29, p. 71.

¹⁶⁶ City of Dallas, Ex. 29, p. 72.

Table 8.1
Consumption Statistics Evaluated by the City of Dallas

	12/31/94	12/31/98	12/31/99	Average
Residential				
Adjusted Customers	212,402	213,086	211,897	212,462
Mcf Sales	18,718,498	18,158,975	17,771,018	18,216,164
MCF/Customer	88.13	85.22	83.87	85.74
Commercial				
Adjusted Customer	25,105	25,543	24,513	25,024
Mcf Sales	15,907,959	15,131,417	14,642,731	15,227,369
MCF/Customer	633.66	594.48	597.35	608.52

Mr. Pous proposes to develop a factor based upon the average for the available statistics. Using that factor, he proposes an adjustment to the MCF sales. The effect of the adjustment would be to increase the residential and commercial sales volumes to reflect the higher average consumption per customer. As a result, hypothetical revenues would increase by \$637,194.

c. Examiners' Analysis and Recommendation

The Examiners agree that a consumption pattern normalization adjustment is not required. As noted by Mr. Florence, the data presented by Mr. Pous reveals that residential consumption per customer has steadily declined since 1994: 88.13 Mcf in 1994, 85.22 Mcf in 1998 and 83.87 in 1999. The decline from 1994 to 1999 was 4.8% and the decline from 1998 to 1999 was 1.6%. Commercial consumption per customer moved from 633.66 Mcf in 1994 to 594.48 Mcf in 1998 to 597.35 Mcf in 1999. Commercial consumption per customer declined 5.7% from 1994 to 1999. The change from 1998 to 1999 was an increase of less than one-half of one percent (0.48%).¹⁶⁷ Finally, the report by the American Gas Association, admitted into evidence at the hearing, declares that nationally, "natural gas use per residential customer dropped 16 percent from 1980 to 1997 from 106 thousand cubic feet (Mcf)/year to 89 Mcf/year (numbers adjusted to reflect normal weather)."¹⁶⁸ The report notes that the "declining use trend" is a "trend likely to continue for the foreseeable future."¹⁶⁹ It concludes by stating that "[r]esidential use per customer is likely to fall at least another five percent over the next 10 to 15

¹⁶⁷ TXU Gas Distribution, Ex. 41, p. 9.

¹⁶⁸ American Gas Association, p. 1.

¹⁶⁹ *Id.*

years.”¹⁷⁰ Except for the meager .48% increase in the commercial class, there is no support in the record for this adjustment.

4. Revenue Adjustment-Base Rate Impact

Issue: Should the base city-gate rate be calculated using the current gas cost of \$4.0200 or should the base gas cost set in GUD No. 8664 of \$2.7535 be used?

Examiners’ Recommendation: It is reasonable to use the gas cost set in GUD No. 8664. Ultimately, the base city-gate rate used will not have an impact on rates because of the purchase gas adjustment and the tax adjustment clauses in the rate design.

Applicant	Intervenor	Examiners
No adjustment.	\$239,210 in additional base rate revenues due to the elimination of gas cost impacts from the cost of service	No adjustment.

a. Applicant’s Position

TXU Gas Distribution proposes to use a base gas cost of \$2.7535 in this case. The current base gas cost rate for the Dallas Distribution System is \$4.0200. That rate was set in the final order issued in *Statement of Intent of Lone Star Gas Company to Changes its City Gate Rate Established in GUD-2087*, GUD No. 3543 (November 22, 1982). The Railroad Commission of Texas set a new base gas cost of \$2.7535 in the final order issued in *Statement of Intent of Lone Star Gas Company and Lone Star Pipeline Company, Divisions of Enserch Corporation, and Ensar Pipeline Company to Increase the Intra-company City Gate Rate*, GUD No. 8664 (November 25, 1997). The Applicant proposes the use of the more recent gas cost.¹⁷¹ In response to the issues raised by the City of Dallas, the Applicant argues that the gas cost adjustment clause and the tax adjustment clauses will ensure that the customer bill will be the same regardless of the base city gate rate.¹⁷²

¹⁷⁰ *Id.*

¹⁷¹ TXU Gas Distribution, Ex. 41, pp. 9-10.

¹⁷² *Id.*

b. Intervenor's Position

The City of Dallas proposes a base rate revenue adjustment that it alleges more accurately reflects an appropriate gas cost adjustment. The City of Dallas alleges that the Applicant's calculation should not reflect a city-gate rate impact on the rates sought in this proceeding and concludes that eliminating the \$4.02 per Mcf gas cost eliminates any artificial impacts on revenue adjustments.¹⁷³

c. Examiners' Analysis and Recommendation

The Examiners agree with Mr. Florence that the Applicant's submittal reflects the more recent base gas cost set prior to GUD No. 8976. Further, the use of the higher city-gate rate ultimately has no impact on the rates set in this case. The gas cost adjustment clauses ensure that the customer bill will be unaffected by the base city-gate rate used to calculate rates in this case. The gas cost adjustment will adjust the gas costs included in the base rate to the actual expense amount.¹⁷⁴ In addition, the Examiners note that Mr. Pous' adjustment would have the immediate effect of increasing base rates.

5. Transport Fees

Issue: Should revenues collected from transactions with Industrial, Electric Generation and Transportation customers be allocated to residential and commercial customers?

Examiners Recommendation: No. Costs of providing service are allocated to all classes of customers. Any further allocation of revenues earned from Industrial, Electric Generation and Transportation customers should not be allocated to residential and commercial customers.

Applicant	Intervenor	Examiners
No adjustment	\$4,476,655 adjustment to revenues collected	No adjustment

TXU Gas Distribution provides a transportation function for TXU Lone Star Pipeline (TXU LSP). Specifically, TXU Gas Distribution transports gas on the Dallas South High Pressure System for TXU LSP from the Dallas South Gate Station to the Dallas Central Gate Station.¹⁷⁵ The City of Dallas argues that the payments made by TXU LSP to TXU Gas Distribution are inadequate.

¹⁷³ City of Dallas, Initial Brief, pp. 23-24.

¹⁷⁴ See generally, Purchased Gas Adjustment Clauses: An Adjuster's Viewpoint, 6 Vol. (1974).

¹⁷⁵ City of Dallas, Ex. 28, p. 26.

a. Applicant's Position

In its Initial Brief, the Applicant points out that, if costs are allocated to a service, no credit of revenues received from that service is required. They argue that Mr. Lawton agreed to this theorem during cross-examination.¹⁷⁶ Mr. Houle explained during cross-examination that residential and commercial customers should receive a benefit from the transportation service. He noted that there were two methods to accomplish that goal. First, the utility can ensure that the transportation customers pay the cost of service. Second, the utility could require a revenue credit.¹⁷⁷ The Applicant argues that this is exactly what has been done.¹⁷⁸ Mr. Anderson testified that the Applicant has allocated the costs to its affiliate, TXU LSP, of its use of the Dallas South High Pressure System. Additionally, the Applicant has allocated to other industrial and transport customers the costs associated with their use of the system.¹⁷⁹

In addition, Mr. Anderson testified that increasing the fee from \$.0501 per Mcf to \$.48 per Mcf, a nearly 1000% increase, is neither reasonable on its face, nor reasonably calculated. Ultimately, the cost analysis that Mr. Lawton engages in is highly speculative and hardly known and measurable.¹⁸⁰ The Applicant alleged in its Initial Brief and throughout the hearing that the rate charged by TXU Gas Distribution to TXU LSP was recently authorized in GUD Docket No. 8976.¹⁸¹

b. Intervenor's Position

Mr. Lawton argues that, in GUD No. 8976, TXU LSP's witness testified that, because of pipeline constraints affecting the ability of TXU LSP to move gas from areas south of Dallas to growing demand areas to the north of Dallas, TXU LSP entered into a transportation agreement with TXU Gas Distribution to move gas from the Dallas South Gate Station to the Dallas Central Gate Station. In GUD No. 8976, TXU LSP included a \$533,760 charge in its cost of service calculation.¹⁸² The Applicant is paid \$.0501 per Mcf for this transportation service in the Dallas Distribution System. In this case, Mr. Lawton notes that the Applicant has included \$539,819 for the revenues from transmission employing the \$.0501 per Mcf rate. As summarized by Mr. Lawton, all of the revenue payments from TXU LSP are included as transmission-related, and not used as an offset to cost of service.

Further, Mr. Lawton argues that the \$539,819 is not the only amount that should be included as an offset to the cost of service. He notes that, in GUD No. 8976, TXU LSP witnesses testified that the alternative to using TXU Gas Distribution facilities would be to construct an alternate system for transportation. In that case, TXU LSP claimed that it would cost \$30 million to construct the necessary facilities. Mr. Lawton calculates that the annual cost for the construction alternative is about \$5,163,592. Consequently, the resulting cost per Mcf, given the test year volume of TXU LSP through the distribution system, is \$.4874 per Mcf.

¹⁷⁶ Tr Vol. 5, p. 120-121.

¹⁷⁷ Tr. Vol. 1, p. 94-95.

¹⁷⁸ TXU Gas Distribution, Initial Brief, p. 70-71.

¹⁷⁹ TXU Gas Distribution, Ex. 48, p. 12.

¹⁸⁰ TXU Gas Distribution, Ex. 48, p. 13.

¹⁸¹ TXU Gas Distribution, Initial Brief, p. 70 & Tr. Vol. 1, p. 73.

¹⁸² City of Dallas, Ex. 29, pp. 26-27.

c. Examiners' Analysis and Recommendation

The Examiners recommend that no adjustment to revenues be calculated based upon the revenues from industrial and transportation customers. Once total system costs are calculated, the costs that residential and commercial customers must pay is the total system costs reduced by the costs that industrial, transportation, and electric generators must bear. The Intervenor urge that, not only should the costs be shared, but the profits made from industrial, transportation, and electric generation customers, over and above their costs, should be shared by all classes of customers as well. The Intervenor do not cite a single case in which this rate-setting scheme has been adopted. Such a proposal is unreasonable. The investors of TXU Gas Distribution should recover those profits and they should bear the loss, if any, as well. However, the Examiners must note that, contrary to TXU Gas Distribution's assertion, the rate that TXU LSP is charged was not specifically approved in GUD No. 8976.

B. Expenses

1. Wages and Salaries

a. Labor Adjustment

Issue: Should labor expense be adjusted to reflect changes in labor in post-test year months?

Examiners' Recommendation: No. The proposed adjustment is outside of the test-year and selectively considers only one aspect of post-test year expenses.

Applicant	Intervenor	Examiners
No adjustment	\$464,609 adjustment to labor-related expenses collected	No adjustment

Total test year labor expenses were calculated at \$8,549,295. TXU Gas Distribution is requesting a reduction of \$261,249 to the Applicant's total test year labor expense. The City of Dallas argues that labor expense should be reduced further.

i. Applicant's Position

Mr. Dixon, testifying on behalf of the Applicant, notes that five of the seven months that the City of Dallas relies on are outside the updated test year in this proceeding. Further, he argues that Mr. Pous' adjustment does not reflect known and measurable changes in the Applicant's labor expense. He argues that the proposed adjustment is based on only one aspect

of the Applicant's cost of service and ignores others. As an example, he notes that the Applicant purposefully slowed its hiring rate in 1999. In some cases, the work performed by employees that left the company during that time period was out-sourced to contractors. The effect of the slow down in hiring was to shift some labor expenses to supplies and expense (*i.e.*, contract labor). Thus, by making only an adjustment to labor, Mr. Pous has missed an adjustment that should have been made to supplies and expenses.¹⁸³

In addition, Mr. Dixon points out a similar effect in the case of Poly 1 replacement. Pursuant to an order of the Railroad Commission of Texas, the Applicant is replacing certain polyethylene pipe in the distribution system. This initiative has resulted in a temporary diversion of some labor resources from operations and maintenance activities to the Poly 1 initiative, which is a capital project. Mr. Pous' proposed adjustment would not take into account the fact that the Applicant's labor expense is lower, in part, because some of the labor expense has been shifted to capital expense. Finally, he notes that there is typically an increase in labor expense during the fall when temperatures are lower and customers begin using more gas. He argues that Mr. Pous overlooks the effect of this seasonal increase in labor expense by excluding the months of September and October from his analysis.¹⁸⁴

ii. Intervenor's Position

Mr. Pous recommends that total labor expenses be reduced by an additional \$464,609 to reflect the decrease in labor expense through May 2000. He argues that the Applicant's monthly labor expense has been steadily declining after the end of the test year and he believes that the Applicant's request should reflect this decline. He notes that the Railroad Commission has in prior cases ordered a reduction in labor expense beyond the test year, the two most recent cases being the *Appeals of Southern Union Gas Company from the Actions of the City of El Paso, Texas*, GUD No. 8878 (November 17, 1998) and GUD No. 8664. Reviewing documents provided by the Applicant, the City of Dallas notes that monthly labor expenses have been steadily declining for the period beginning January 1997 through May 2000.

iii. Examiners' Analysis and Recommendation

The Examiners recommend that no further adjustment be applied to the labor expense category. The proposed adjustment is outside of the test year and selectively considers only one aspect of post test year changes to expenses.

¹⁸³ TXU Gas Distribution, Ex. 46, p. 6.

¹⁸⁴ TXU Gas Distribution, Ex. 46, pp. 7-8.

b. Adjustments to fringe benefit allocation

Issue: Should labor fringe benefit expenses be allocated from TXU Gas Distribution to the Dallas Distribution System on the basis of a customer allocation factor?

Examiners' Recommendation: Yes. The Applicant has established that labor allocation of labor fringe benefit expenses is reasonable.

Applicant	Intervenor	Examiners
No adjustment	\$312,214 adjustment to labor-related expenses collected	No adjustment

The Applicant has applied a customer allocation factor to allocate fringe benefit expenses for TXU Gas Distribution to the Dallas Distribution System. As discussed in the context of general plant, etc. in Section VI above, the City of Dallas argues that this is an inappropriate assignment factor.

i. Applicant's Position

Barbra Myers, testifying on behalf of TXU Gas Distribution, explained that the Applicant has consistently used the same allocation method to assign its costs to the Dallas Distribution System. Operation and maintenance expense have consistently been allocated based on the ratio of customers in a town as a ratio of total customers within a system. Operation and maintenance expenses are first charged to a specific department and then the expenses for that specific department is allocated based on a customer ratio. She testified that TXU Gas Distribution has consistently allocated costs in this manner in municipal filings in 1994 and 1999. In response to arguments raised by Mr. Pous, Ms. Myers states that TXU Gas Distribution does use a labor allocation factor to allocate SFAS 106 costs to each its departments. Once costs are recorded TXU Gas Distribution then allocates those costs based on the ratio of customers in a town to total customers in the system.¹⁸⁵

ii. Intervenor's Position

Mr. Pous argues that a labor allocation factor is far superior to the customer allocation factor used by TXU Gas Distribution for employee fringe benefit expenses. He alleges that in the last complete rate case, the Applicant relied on a labor allocation factor to assign SFAS 106

¹⁸⁵ TXU Gas Distribution, Ex. 39, pp. 5-6.

expense to the Dallas Distribution System. He suggests that the inconsistent use of allocation factors to artificially increase revenue requirements is inappropriate.¹⁸⁶

iii. Examiners' Analysis and Recommendation

The Examiners recommend that fringe benefits be allocated on the basis of total number of customers. TXU Gas Distribution allocates all of its labor costs on that basis and the City of Dallas has not established that the Applicant has applied inconsistent allocators in this context.

2. Depreciation

a. General

Rate base is the value of utility property upon which a utility is permitted to earn its rate of return.¹⁸⁷ Rate base is made up of several components. Distribution plant investment and general plant make up two of those components.¹⁸⁸ As is seen in this case, distribution plant investment is original cost, less accumulated depreciation.¹⁸⁹ Accumulated depreciation is based on the depreciation rates that were set in the prior rate case and are reflected in the existing tariff.¹⁹⁰ The depreciation rates that were authorized in the prior rate case are used to calculate and move the depreciation expense to the reserves that make up accumulated depreciation.¹⁹¹ A similar analysis is conducted for general plant.¹⁹² The depreciation rates that are set in this case will invariably affect the calculation of accumulated depreciation in future cases. The Applicant has requested \$7,236,086 of depreciation expense in this case.¹⁹³

¹⁸⁶ City of Dallas, Ex. 29, p. 99.

¹⁸⁷ *Railroad Commission of Texas v. Lone Star Gas Company*, 599 S.W.2d 659, 660 (Tex. App.—Austin 1980).

¹⁸⁸ TXU Gas Distribution, Revised Ex. 4, Primary Exhibits, p. 11.

¹⁸⁹ TXU Gas Distribution, Revised Ex. 4, Primary Exhibits, p. 7-2.

Calculation of total distribution plant classified to the DDS.

Total Distribution Plant-Per Book Original Cost	\$197,266,627
Accumulated Depreciation	\$74,659,935
Total Distribution Plant included in Rate Base (\$197,266,627-\$74,659,935)	\$122,606,692

¹⁹⁰ Tr. Vol. 4, p. 25.

¹⁹¹ *Id.*

¹⁹² TXU Gas Distribution, Revised Ex. 4, Primary Exhibits, p. 7-6.

Calculation of general plant classified or allocated to TXU Gas Distribution (As proposed by the Applicant)

Total General Plant-Per Book Original Cost	\$116,543,882
Accumulated Depreciation	\$56,841,877
Total General Plant included in Rate Base (\$116,543,882-\$56,841,877)	\$59,702,005

The amount of total general plant that TXU Gas Distribution proposes to allocate to DDS is based on the ratio of total DDS customers to total TXU Gas Distribution Customers, 0.171479, or \$10,237,640. As discussed previously in Section 5 above, the Examiners have recommended an assignment of total costs based on distribution plant ratios.

¹⁹³ TXU Gas Distribution, Exhibit 4, Primary Exhibits

Depreciation, as applied to depreciable utility plant, means the loss in service value not restored by current maintenance. Such loss may be incurred in connection with the consumption or prospective retirement of utility plant in the course of service from known causes against which the utility is not protected by insurance. Among the causes for depreciation are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in demand and requirements of public authorities, and, in the case of natural gas companies, the exhaustion of natural resources.¹⁹⁴

The goal of depreciation is to allocate or assign a dollar amount to the reduction in worth or value occurring in each accounting period.¹⁹⁵ The reduction in value starts when the asset is placed in service and the value of an asset is considered as being consumed during the provision of service. As a result, a charge is made to the cost of production, over the asset's life, by some equitable method of allocation.¹⁹⁶ As summarized by NARUC, "depreciation accounting is fundamentally a process of allocating in a systematic and rational manner the value of a depreciable asset over its life."¹⁹⁷

The Austin Court of Appeals has defined depreciation as follows: "Depreciation rate" means the percentage of investment in a plant that should be recognized annually as a depreciation expense; depreciation expense, a dollar figure, is the result of applying the depreciation rate to the plant account balances, which are also dollar figures.¹⁹⁸ The Railroad Commission is obligated to examine the depreciation expense in setting rates.¹⁹⁹ However, Courts have recognized that depreciation cost accounting is generally considered within an agency's discretion.²⁰⁰

In this docket, depreciation rates will be established for two general classes, or functional groups, of property used by TXU Gas Distribution: (1) the Distribution Plant, and (2) General Plant.²⁰¹ The current balance in the Distribution Plant group for all of TXU Gas Distribution is \$825,996,904.²⁰² The Distribution Plant functional group is made up of pipelines and associated facilities used to distribute gas to residential and small commercial customers.²⁰³ The current balance in the General Plant group for TXU Gas Distribution is \$19,722,087.²⁰⁴ The General Plant functional group contains facilities associated with the overall operation of TXU Gas Distribution. This group includes office buildings, office equipment, and computers.²⁰⁵

¹⁹⁴ NARUC definition, City of Dallas, Exhibit 29, p. 11.

¹⁹⁵ Examiners Exhibit 3, Public Utility Depreciation Practices, August 1996, NARUC.

¹⁹⁶ *Id.*

¹⁹⁷ *Id.*

¹⁹⁸ *West Texas Utilities Co. v. Office of Public Utility Counsel*, 896 S.W.2d 261, 268 (Tex. App. – Austin 1995) (*West Texas Utilities*).

¹⁹⁹ Tex. Util. Code § 104.054. *West Texas Utilities* at 268.

²⁰⁰ *Northwest Airlines, Inc. v. C.A.B.*, 340 F.2d 789, 791 (D.C.Cir. 1964).

²⁰¹ TXU Gas Distribution, Ex. 19, DAW-S-1, p. 19.

²⁰² TXU Gas Distribution, Ex. 19, pp. 19 & 22.

²⁰³ TXU Gas Distribution, Ex. 19, p. 9.

²⁰⁴ TXU Gas Distribution, Ex. 19, pp. 19 & 22.

²⁰⁵ *Id.*

TXU Gas Distribution has requested from the Dallas Distribution System customers an annual depreciation expense of \$7,236,086.²⁰⁶ The requested depreciation expense for the Distribution Plant functional group within the Dallas Distribution System is \$6,149,870 and the requested depreciation expense for the General Plant functional group within the DDS is \$1,086,216.²⁰⁷ The City of Dallas argues that the provision for depreciation should be \$3,168,073.²⁰⁸ Before analyzing the specific issues raised in the depreciation analysis prepared by the Applicant, the parties have raised several general observations about their respective development of a depreciation expense calculation.

Depreciation rates are generally determined through a depreciation study. The Applicant explained the activities that comprise a depreciation study generally fall within four distinct phases. The first stage involves data collection. The second stage involves data analysis. The third stage involves data evaluation, which draws upon the collected data. Finally, the fourth stage involves the calculation of depreciation rates and the corresponding recommendations.²⁰⁹ Table 8.2 provides a summary of the various stages.

Table 8.2
Stages of a Depreciation Study

Stage 1 Data Collection	Stage 2 Analysis	Stage 3 Evaluation	Stage 4 Calculation	Recommendation
Retirements and survivors Account Content Other Discussion with accounting, engineering, planning and operations personnel Gross salvage and cost of removal	<ul style="list-style-type: none"> •Service Life •Salvage Value 	Evaluation of analysis results and selection of mortality characteristics	<ul style="list-style-type: none"> •Calculate accrual rates •Test book reserve position 	

The Applicant points out that the average composite depreciation rate for gas utilities reporting to the American Gas Association Depreciation Survey is 3.39%.²¹⁰ Mr. Watson argues that depreciation rates that significantly deviate from the industry norm should be subjected to increased scrutiny. He notes that Mr. Pous has taken a similar position in other cases.²¹¹ In this case, Mr. Watson points out that Mr. Pous' recommendations would impose upon TXU Gas Distribution a depreciation rate that is 200% less than the average composite rate used by the rest of the industry.

²⁰⁶ TXU Gas Distribution, Revised Ex. 4, p. 1-5.

²⁰⁷ *Id.*

²⁰⁸ In City of Dallas Ex. 31, Revised Exhibit JP-1, p. 3, the City of Dallas argues that the provision for depreciation should be \$3,520,463. In its Initial Brief, the City of Dallas argued that cross-examination of TXU Gas Distribution's witness, Dane Watson, revealed that an addition \$352,390 should be deducted from TXU Gas Distribution's depreciation request.

²⁰⁹ TXU Gas Distribution, Ex. 47, p. 8.

²¹⁰ TXU Gas Distribution, Ex. 47, p. 5.

²¹¹ TXU Gas Distribution, Ex. 47, p. 5. He notes that, in pre-filed testimony in GUD Docket No. 9002-9135, dated May 22, 2000, he stated that the rates proposed by Energas should be subjected to greater scrutiny since the proposed rates deviated from the mean value of the composite depreciation rate for gas utilities by 57%.

Finally, Mr. Watson argues that the adjustment amounts in the context of average service lives are not only unwarranted, but are incorrectly calculated. The adjustments fail to take into account the change in allocation factor that must occur within the accumulated reserve if any of the Applicant's proposed life, net salvage or depreciation system parameters are modified. He points out that this is because the Applicant only maintains the reserve on a functional level.²¹²

Conversely, Mr. Pous alleges that the Applicant deviated from supportable and well-reasoned depreciation approaches/methods and turned to reliance on vague or generalized statements for its proposal. He argues that Mr. Watson did not create any contemporaneous documentation at the time he developed the depreciation study.²¹³ He urges that the lack of contemporaneous documentation for critical decisions in a subjective area that results in multi-million dollar depreciation expenses for an upcoming rate case is unacceptable.

b. Methodology: ELG vs. ALG

Issue: Should the depreciation calculations for the Dallas Distribution System be changed from the ALG methodology adopted in the last municipal rate case or should it be changed to ELG.

Examiners' Recommendation: The ALG methodology should be retained for the Dallas Distribution System. As calculated by the City of Dallas, the proposed change results in an approximately \$881,840 rate increase.

Applicant	Intervenor	Examiners
No adjustment	\$881,840 adjustment based on retention of the ALG methodology.	\$881,840 adjustment, as calculated by the City of Dallas, based on retention of the ALG methodology.

A key depreciation issue in this case is whether to use the Equal Life Group (ELG) or Average Life Group (ALG) method of computing depreciation expense. ELG and ALG are both accepted methods of depreciation.²¹⁴ The principal difference occurs in how the assets are grouped to determine average service lives. ELG groups assets together that have similar characteristics as one composite asset and assigns a retirement date, while ALG groups assets that are tracked individually, but used together functionally, and computes retirement based on the average useful life of the group.

²¹² TXU Gas Distribution, Ex. 47, p. 29.

²¹³ City of Dallas, Ex. 29, 12.

²¹⁴ See generally, Examiners' Exhibit 3, Public Utility Depreciation Practices, p. 165. Nevertheless, NARUC points out that ELG is not a recognized procedure in all regulated industries or by all regulatory authorities. It is, however, recognized by the FCC and the ICC, and many state commissions.

i. Applicant's Position

TXU Gas Distribution argues that it is requesting that the Commission continue to allow it to use the ELG depreciation procedure that was approved by the Commission in GUD No. 8664.²¹⁵ The Applicant points out that in GUD No. 8664 the Commission found that ELG “provides a more accurate estimate of actual consumption of property”²¹⁶ In its initial Brief, the Applicant states that based on the Commission’s approval of the ELG procedure in GUD No. 8664, TXU Gas Distribution has implemented ELG-developed rates for its General Plant accounts. TXU Gas Distribution has also implemented ELG-developed rates for its distribution property in approximately 80 cities served by the Applicant.²¹⁷

Mr. Watson points out that the ALG or Broad Group procedure, as it is commonly referred to in depreciation literature, considers all units of plant within a particular depreciation category, usually a plant account, sub-account or function to be considered in one group. The ALG procedure treats each unit in the vintage group²¹⁸ as having identical life characteristics, thus producing an averaging effect for the life of the group. He asserts that benefits of ELG are that it provides a more accurate estimate of actual consumption of property (theoretically more correct) and allows TXU Gas Distribution to more appropriately use and recover its asset costs.²¹⁹

Mr. Watson points out that depreciation experts such as Dr. W. Chester Fitch, Dr. Frank Wolf, and Professor Winfrey agree that ELG has been recognized as a theoretically correct procedure.²²⁰ He quotes Dr. Winfrey for the proposition that ELG is “the only mathematically correct [depreciation] procedure.” In response to the City of Dallas’ criticism that ELG rates are time sensitive, Mr. Watson argues that all depreciation rates, whether ALG or ELG, are time sensitive. ALG rates depend on historical balances, remaining lives, and how well assumed life and salvage parameters match current experience.²²¹

ii. Intervenor's Position

Mr. Pous argues that, while the Commission has approved the ELG procedure for one *pipeline* company, TXU LSP, it has also denied the use of the ELG depreciation method for a *distribution* company in *Appeal of Southern Union Gas Company from the Action of the Cities of Groves Nederland, Port Arthur and Port Neches Texas*, GUD No. 8033 (June 15, 1997).²²² Mr. Pous argues that the existing depreciation rates reflected in charges to customers are based on the

²¹⁵ TXU Gas Distribution, Initial Brief, p. 27.

²¹⁶ GUD No. 8664, Second Order Nunc Pro Tunc FOF, 92 (November 25, 1997).

²¹⁷ TXU Gas Distribution, Ex. 47, p. 39.

²¹⁸ Vintage group is defined as plant that is placed in service during the same year. See, Examiners’ Exhibit 3, Public Utility Depreciation Practices, p. 326.

²¹⁹ TXU Gas Distribution, Exhibit 19, pp. 14-15.

²²⁰ TXU Gas Distribution, Exhibit 47, p. 40.

²²¹ Id.

²²² City of Dallas, Ex. 29, 43.

ALG procedures. In addition, Mr. Pous takes issue with the Applicant's claim that the ELG procedure is more theoretically accurate.²²³

Denial of the Applicant's attempt to initiate the ELG procedure for a gas distribution system is particularly appropriate, given the lack of long-term mortality data associated with the majority of investments in a local distribution system.²²⁴ This unique aspect of the Applicant's investment clearly differentiates it from TXU Lone Star Pipeline, which was granted the right to use ELG. He argues that for ELG to be accurate in the rate setting process two all but impossible situations need to transpire. First, an analyst would have to be able to forecast with absolute precision the annual retirement patterns of investment for as much as 100 years into the future. Second, the Applicant would need to perform annual depreciation studies and implement rate changes and plant balance changes in annual rate cases.²²⁵

Mr. Pous points out that a very small minority of energy companies in the United States utilize ELG. He points to the American Gas Association/Eddison Electric Institute's Annual Survey of Depreciation Statistics (Survey) and notes that only five electric utilities and four gas utilities use ELG. Based on this Survey, over ninety percent of the electric and gas utilities nationwide use the ALG procedure to calculate mass property depreciation rates.²²⁶ He notes that neither the ICC nor FCC regulate energy companies and he notes that the Federal Energy Regulatory Commission (FERC) has specifically denied the use of the ELG procedure. Finally, he also points out that the Nevada Public Service Commission, the Oklahoma Corporation Commission, the Illinois Commerce Commission, the Connecticut Department of Public Utility Control and the Public Utility Commission of Texas have all rejected ELG.

iii. Examiners' Analysis and Recommendation

The Examiners recommend that the Commission adopt the ALG depreciation methodology for General Plant and Distribution Plant. While the Commission approved the use of ELG for the General Plant account for TXU Lone Star Pipeline in GUD No. 8664, the discussion that led to that approval indicated that consistency with GUD No. 8664 was an important factor in the decision. However, the current rates within the City of Dallas reflect depreciation rates derived using the ALG methodology. Therefore, in that context, TXU Gas Distribution is proposing a fundamental change from prior ratemaking decisions. That change alone accounts for over \$800,000 of the cost of service increase proposed in this case. That dollar amount is not associated with the addition of plant, nor is it associated with increased operation expenses. Indeed, TXU Gas Distribution in its Initial Brief states that operating costs have decreased.²²⁷ Thus, the cost of service for depreciation has increased over \$800,000 due primarily to a change in methodology. Mr. Watson states that depreciation expense must increase in order to reflect the over \$52.8 million increase in capital investment that TXU Gas

²²³ City of Dallas, Ex. 29, p. 44. Mr. Pous argues that claiming theoretical superiority for the "accuracy of ELG is no different than claiming the examiners in this case will win a multimillion-dollar lottery. While the statement may be true in theory, unfortunately for the examiners, the probabilities are very remote."

²²⁴ City of Dallas, Initial Brief, p. 28.

²²⁵ *Id.*

²²⁶ City of Dallas, Ex. 29, p. 45.

²²⁷ TXU Gas Distribution, Initial Brief, pp. 2-3. Mr. Houle testified extensively regarding merger savings. *See generally*, Vol. 1, 30, 46, 55, 59, 60 & City of Dallas Ex. 5.

Distribution has made in the DDS since 1995. He states that the total increase is approximately \$1.1 million dollars. Thus, nearly seventy-three percent of the increase is due to the adoption of the ELG methodology.

The reason for this impact is apparent when both methodologies are compared. Under the ALG procedure, an average percentage rate is applied annually to the surviving property balance throughout the life of the vintage. The total cost of the vintage is fully allocated to expense when the last surviving unit in the vintage is retired. On the other hand, the ELG procedure is designed to charge to depreciation expense the investment in each equal life group by the time each group is completely retired. For example, if a group has a two-year life, its original capital costs should be allocated to expense by the end of the two years, while plant expected to survive five years is completely expensed only at the end of five years.²²⁸

Example 8.1 compares a simplified scenario. In this example, there are only three units within a functional group. Each unit costs \$10,000 and the average service life is one year, two years, and three years respectively. The ALG methodology would calculate the depreciation rate based upon the average service life of the longest surviving unit. Using the ELG methodology, the functional group is divided into equal life groups in this example, corresponding to each unit.

²²⁸ Examiners Ex. 3, p. 165.

Example 8.1²²⁹**Comparison of Annual Depreciation Using ALG versus ELG for one Functional Category**

Step 1: Hypothetical components of a functional group with corresponding cost, average service life, and salvage value.

Three units

Unit 1	Cost \$10,000	Life=1 year	Salvage=0
Unit 2	Cost \$10,000	Life=2 years	Salvage=0
Unit 3	Cost \$10,000	Life=3 years	Salvage=0

Step 2: Calculation of the ALG rate.

ALG rates calculated based on total cost divided by average service life of the longest surviving unit: $\$30,000/3 = \$10,000$.

Step 3: Calculation of the ELG rate.

- a. The functional group is divided into individual life groups.
- b. The depreciation for each unit is calculated using the average service life of that unit.
- c. As each unit becomes fully depreciated, a depreciation rate is no longer calculated.

Beginning of year amount				
\$30,000	\$10,000	<i>One year life group</i>		
\$20,000	\$5,000	\$5,000	<i>Two Year life group</i>	
\$10,000	\$3,333	\$3,333	\$3,333	<i>Three year life group</i>

Step 4. Compare the accrual rates

Total Accruals	Year 1	Year 2	Year 3
ELG	\$18,333	\$8,333	\$3,333
ALG	\$10,000	\$10,000	\$10,000

Comparing the results reveals why ELG produces higher depreciation rates in earlier years. From a regulatory perspective, the problem is that the rate set is based upon the results in the earlier years. If the rates could be revised in the second or third year to adjust for deviations from the original estimate, the results may not be so severe; however, such revisions could only be accomplished through annual rate cases. Furthermore, in this case, the driving force for the requested rate increase is over fifty million dollars in new investment. Thus, the depreciation

²²⁹ Derived, in part, from *Public Utility Depreciation Practices*, Examiners' Ex. 3, p. 166.

rates for the new property will be substantially higher in the early years. In addition there is no effective correction for higher accruals in the early years.

On the other hand, the ELG procedure has been approved and is currently reflected in the Applicant's distribution rates in approximately 80 cities served by the Applicant. The Railroad Commission in GUD No. 8976 indicated that regulatory consistency was an important consideration in its decision to continue the use of the ELG methodology in that case.²³⁰ and this Commission has ruled that, the ELG methodology is reasonable.²³¹ There are several factors, however, that distinguish this the Dallas Distribution System operated by TXU Gas Distribution from TXU LSP.

First, this is the first distribution case in which TXU Gas Distribution has requested approval from the Railroad Commission of Texas of ELG-calculated rates. Second, the ELG methodology has already been rejected by the Railroad Commission of Texas for a distribution system, thus regulatory consistency for distribution systems is at issue. Third, the driving force behind the requested rate increase was the investment in new distribution plant. As vintage groups depreciate faster using the ELG methodology, the impact of ELG is greatest on new plant. Finally, the City of Dallas cited numerous instances in which jurisdictions have rejected the use of ELG. Consequently, the Examiners recommend that the ALG methodology proposed by the Intervenors be adopted.

c. Average Service Lives

The determination of service lives applicable to each asset category is important since it is the asset's service life that determines the period over which its costs are depreciated.²³² Average service lives are computed the same whether ELG or ALG is the chosen procedure. Generally, shorter service lives will result in higher depreciation rates than longer service lives. As summarized in Schedule 8.3, the Applicant's depreciation study involved eighteen mass asset categories.²³³

²³⁰ GUD No. 8976, FOF 132. See also, Transcript of Open Conference, June 20, 2000 explaining its decision to continue the use of the ELG methodology, pp. 5 & 41.

²³¹ GUD No. 8664, FOF 92: Because it provides a more accurate estimate of actual consumption of property, the ELG depreciation procedure requested by Lone Star is reasonable; GUD No. 8976, FOF 134: The ELG depreciation method used by TXU LSP is reasonable and should be retained.

²³² TXU Gas Distribution, Initial Brief, p. 30.

²³³ TXU Gas Distribution, Ex. 19, DAW-S-1, p. 19.

Table 8.3
Mass Asset Categories

Distribution Plant		General Plant	
<i>Acct.</i>	<i>Description</i>	<i>Acct.</i>	<i>Description</i>
374	Land Rights	390	Structures
375	Structures and Improvements	391	Furniture and Fixtures
376.3	Mains-Plastic	392	Transportation
376.4	Mains- Valves	396	Power Operated Equipment.
376.5	Mains-Steel Mill Wrapped & Bare	397	Communication Equipment
378	M&R Equipment	398	Computer Equipment
379	City Gate Equipment	398	Miscellaneous Equipment
380	Services		
381	Meters		
383	House Regulators		
387	Other Equipment		

As depreciation allocates the cost of an asset, or group of assets, over the useful life of the assets, accurately estimating the life of the asset is an important component of depreciation analysis.²³⁴ For life analysis purposes, the ages at retirement are usually expressed in the form of retirement or survivor curves.²³⁵ It is the selection of the life and curve that governs the accrual rate and reserve rate used to calculate a theoretical reserve.²³⁶ Physical property retirements generally follow definable patterns that can be standardized. *Iowa curves* are standard curves that were empirically developed to describe the life characteristics of most industrial and utility property. They are the result of extensive analysis by professors at Iowa State University.²³⁷ Both witnesses agree that these curves represent retirement frequency patterns of empirically derived data over extensive periods of time and both witnesses rely substantially on *Iowa curves* in developing average service lives and they are used throughout the utility industry.²³⁸

The average services lives of five accounts and corresponding dispersion patterns are challenged by the City of Dallas: (1) Account No. 376.3 Mains-Plastic; (2) Account No. 376.4 Mains-Valves; (3) Account No. 376.5 Mains-Steel Mill Wrapped/Bare; (4) Account No. 380 Services; and (5) Account No. 398 Computer Equipment. The total adjustments recommended, as calculated by the City of Dallas with regards to average service life result in a \$1,194,856 reduction in the proposed depreciation request of TXU Gas Distribution.²³⁹ Table 8.4 summarizes the relative positions of the parties regarding the average service lives.

²³⁴ Examiners' Ex. 3, p. 67

²³⁵ *Id.*

²³⁶ Tr. Vol. 4, 32. The result of selecting an alternative curve is the calculation of a different theoretical reserve.

²³⁷ Examiners' Ex. 3, p. 124. The *Iowa curves* were originally conceived by Edwin Kurtz and developed by Robley Winfrey.

²³⁸ Examiners' Ex. 3, p. 68; City of Dallas, Ex. 29 at Tab B, TXU Gas Distribution, Ex. 18, at DAW-S-1, p. 5.

²³⁹ Intervenor's Initial Brief, p. 32.

Table 8.4
Positions of the parties regarding average service lives

	Applicant-Curve	Applicant-ASL	Intervenor-Curve	Intervenor-ASL	Examiners ASL & Curve
376.3: Mains-Plastic	R2.5	60	R2	70	70 R2
376.4: Main-Valves	R4	45	R1.5	70	45 R4
376.5: Mains-Steel Mill Wrapped/Bare	R2	60	R1.5	70	70 R1.5
380: Services	R2	33	L1.5	38	38 L1.5
398: Computers	R5	5	Amortize	Amortize	5 R5

i. Account 376.3: Mains-Plastic

Issue: Should the average service life for Account 376.3 be 60 years or 70 years?

Examiners' Recommendation: The average service life for this account should be within the reasonable range originally established by the Applicant.

Applicant	Intervenor	Examiners
60 year average service life with a corresponding R2.5 <i>Iowa curve</i>	\$390,040 adjustment based on the use of 70 year average service life with corresponding R2 <i>Iowa curve</i> .	\$390,040 adjustment, as calculated by the City of Dallas, based on the use of a 70 year average service life with corresponding R2 <i>Iowa curve</i>

Distribution mains, represents the largest single category of investment at issue in this case, along with the highest level of corresponding depreciation expense.²⁴⁰ TXU Gas Distribution proposes an average service life for Account 376.3, Mains-Plastic Mains, of 60 years. The City of Dallas proposes an average service life of 70 years.

²⁴⁰ TXU Gas Distribution, Ex. 19, DAW-S-1, p. 19.

(a) Applicant's Position

Mr. Watson stated that the selection of curve and life for Account 376.3 is based on a combination of historical analysis, engineering judgment, knowledge of property in the account, the practice at TXU Gas Distribution, and experience of field personnel.²⁴¹ In his analysis, Mr. Watson notes that engineering judgment is not as critical in cases where there are specific, significant pieces of information that influence the choice of life or curve. Where there are multiple factors, on the other hand, engineering judgment is used.²⁴²

Mr. Watson explained that plastic mains have been installed since the early 1960s. Most new mains installed today are plastic. The number of miles of plastic pipe on the system has more than doubled since 1983. Since the last depreciation study in 1995, the balance in this account has grown more than eighty percent. He argues that judgment must be coupled with the results of life analysis in order to determine a reasonable average service life because the majority of this account is relatively new. To analyze historical data, placement bands²⁴³ and experience bands²⁴⁴ were prepared and visual plots of observed life tables from band analysis and survivor curves were generated and analyzed.

Various placement bands, 1960-1999, 1970-1999, 1980-1999 with experience bands, 1962-1999, 1970-1999, and 1980-1999 were analyzed. Mr. Watson concluded that for the overall band, 1960-1999 placement band with a 1962-1999 experience band, the 60 R2.5 matched "well through age 20."²⁴⁵ In addition, using a 1960-1999 placement band with a narrower experience band, such as 1980-1999 and 1990-1999, the 60 R2.5 curve was a "good visual fit."²⁴⁶ Likewise, using the 1970-1999 placement band with changing experience band, the 60 R2.5 curve also provided a "good visual match."²⁴⁷

Once Mr. Watson selected what he considered to be an appropriate average service life, he sought confirmation from engineers to "validate this historical conclusion."²⁴⁸ He argues that company engineers stated that the life of early generation plastic is about thirty years. As technology improved, engineers estimated that plastic mains would last forty to fifty years. Mr. Dixon testified that the pipe manufacturer's predicted life for plastic pipe of one-hundred years was overstated and he testified that TXU Gas Distribution has experienced brittle cracking failure.²⁴⁹ He alleges that the TXU Gas Distribution engineers concluded that an average service

²⁴¹ TXU Gas Distribution, Ex. 47, DAW-R-2, p. 1.

²⁴² *Id.*

²⁴³ The use of different placement bands allows the analyst to isolate the effects of changes in technology and materials that occur in successive generations of plant. Examiners' Exhibit 3, p. 113-114.

²⁴⁴ Experience bands show the composite retirement history for all vintages during a select set of activity years, Examiners' Ex. 3, p. 114.

²⁴⁵ TXU Gas Distribution, Ex. 47, DAW-R-2, p. 2.

²⁴⁶ *Id.*

²⁴⁷ *Id.*

²⁴⁸ TXU Gas Distribution, Ex. 47, DAW-R-2, p. 3; Tr. Vol 8, pp. 14-21.

²⁴⁹ TXU Gas Distribution, Ex. 46, p. & Tr. Vol 7, p. 178.

life of sixty years was appropriate because it balanced shorter life from earlier generation plastic pipe with improvements in resin technology on new pipe currently being installed.²⁵⁰

Mr. Watson raises several issues with regards to Mr. Pous' calculation of an average service life for this account. First, he claims that Mr. Pous relied to a marked degree on statistical ranking to justify his selection of a 70-year average service life for this account. He points out that Mr. Pous admitted in his deposition that statistical ranking can be very misleading. Second, Mr. Pous relied on a single placement band to support his 70-year average service life recommendation, even though he criticized TXU Lone Star Pipeline in GUD No. 8976 for using a single placement band analysis. Third, he alleges that Mr. Pous performed limited visual matching that was focused on a single placement band. Finally, he criticizes Mr. Pous for failing to interview field operations personnel familiar with the investment at issue.²⁵¹

(b) Intervenor's Position

The City of Dallas points out that the Applicant did not initially present any specific basis for how it arrived at the 60-year average service life with the corresponding R2.5 Iowa Survivor curve. Mr. Pous argues that Mr. Watson provided documents attempting to justify its proposal immediately prior to his deposition. He characterized the Applicant's additional information as stating that the key to Mr. Watson's determination was the "validation" from unidentified engineers.²⁵²

Mr. Pous is recommending a 70-year average service life with corresponding R2 Iowa Survivor Curve. His recommendation is based on a review of the results of the actuarial analysis, knowledge of the type of investment, manufacturer's indications for life expectancy, advancement in technology, and his experience and judgment. Mr. Watson points out that not one single analysis performed by the Applicant produced an average service life as low as 70 years corresponding to the statistical best fit. In fact, he adds, the shortest average service life corresponding to the highest ranked statistical fit performed by the Applicant was in excess of 62 years. During the hearing, Mr. Watson confirmed that his own actuarial analysis indicated that the best ranking curve was 62.3 years.²⁵³ Moreover, the average "average service life" corresponding to the best statistical fit for each of the Applicant's analysis resulted in 82 years. Mr. Pous points out that the goal is not to find a curve that matches "well", the goal is to find the best fitting curve.

Mr. Pous provided a graphical comparison of Mr. Watson's selection to the selection proposed by the City of Dallas. Mr. Pous argues that the 70-year average service life provides a better fit. In response to Mr. Watson's argument that some engineers claim that the actual survivor curve for early generation plastic pipe is 30 years, Mr. Pous points out that, if TXU Gas Distribution had installed pipe with a thirty year life in the ground in 1960, then by the early 1990s it should have retired it. Finally, he points out, as the actual survivor curve for this account has not declined below a 94% surviving level after 38 years of age, Mr. Watson's

²⁵⁰ *Id.*

²⁵¹ TXU Gas Distribution, Ex. 47, pp. 10-11.

²⁵² City of Dallas, Ex. 29, p. 17.

²⁵³ Tr Vol. 3, p. 216 & Dallas Ex. 21.

reliance on the engineers judgment was unreasonable. Technological advancements also help justify a longer ASL than that proposed by the Applicant.

(c) Examiners' Analysis and Recommendation

The Examiners recommend that the average service life of seventy years with a corresponding R2.5 *Iowa curve* be adopted for this account. Mr. Watson admits that his analysis is based, in part, on his interpretation of the *Iowa curve* for this account.²⁵⁴ Mr. Watson's actuarial analysis concluded that the *Iowa curve* with the best fit indicated an average service life of 62.3 years. The reasonable range suggested by his analysis was from sixty years to one hundred years. Based on Mr. Dixon's testimony, it was reasonable to conclude that an average service life in the higher end of the range was unrealistic. However, it was not reasonable to select an *Iowa curve* that was not even within the range suggested by Mr. Watson's actuarial analysis.

As pointed out by Mr. Pous, the average "average service life" was eighty years. Instead of selecting an average service life within the range suggested by Mr. Watson's own actuarial analysis, Mr. Watson selected an average service life of sixty years. He claims that consultation with field engineers confirmed that a sixty-year average service life was reasonable given the Applicant's experience with this type of pipe. His discussion with field engineers confirmed that the upper range of the placement bands was unreasonable. However, his account of his consultation with engineers does not support the decision to select an average service life outside of the range.

ii. Account 376.4: Mains-Valves

Issue: Should the average service life for Account 376.4 be 45 years or 70 years?

Examiners' Recommendation: The average service life for this account should be 45 years.

Applicant	Intervenor	Examiners
45 year average service life with a corresponding R4 <i>Iowa curve</i>	\$51,000 adjustment based on the use of 70 year average service life with corresponding R1.5 <i>Iowa curve</i>	45 year average service life with a corresponding R4 <i>Iowa curve</i>

²⁵⁴ Both witnesses indicated that developing an average service life can be accomplished, in part, through the analysis of *Iowa Curves*.

(a) Applicant's Position

The Applicant argues in its closing brief that the City of Dallas failed to offer any closing statement in support of Mr. Pous' proposed service life recommendation for this account. The Applicant argues that the Intervenor's failure in this regard is clearly the result of an absence of evidentiary support for Mr. Pous' recommendations, therefore, and the Applicant requested summary disposition on this issue.²⁵⁵

Mr. Watson argues that the average service life for this account cannot be equated with the average service lives for the plastic mains account. He presents documentation in support of the proposition that valves have a shorter life expectancy than pipe. The primary cause of valve failure is due to leaking of valve seals. Thus, the Applicant would not only replace the valve because of a problem with the connected main, but would replace it for many other reasons that would not require simultaneous replacement of the main.²⁵⁶ Indeed, in conversations with a manufacture of valves, Mr. Watson confirmed that the average service life for its product was within the range of twenty-five to thirty years.²⁵⁷

Mr. Watson raises several issues regarding Mr. Pous' recommendation of a 70-year average service life for this account, 376.3. First, he argues that Mr. Pous inappropriately attempted to link his average service life recommendation for this account to his average service life recommendation for the mains account. He states that Mr. Pous incorrectly attempts to equate the service life for the mains with the service life for the valves even though the Applicant's actual operational experience with valves is much shorter. Second, he alleges that Mr. Pous inappropriately relies on statistical results to support his average service life recommendation for this account. Third, he argues that his analysis was limited to a single placement band in order to arrive at his 70-year average service life.²⁵⁸

(b) Intervenor's Position

The Intervenor's argue that the Applicant initially failed to provide any specific justification for its proposal. The Applicant supplemented its claimed basis for its proposal late in the afternoon on the day before Mr. Watson's scheduled deposition. Mr. Pous recommends a 70-year average service life with a corresponding R2 *Iowa curve*. He states that this recommendation is based on his review of the actuarially-derived observed life tables, the relationship of this investment to other distribution mains sub-accounts, proper recognition of technological advancement and a more appropriate understanding of the life relationships.

The City of Dallas claims that the statistical results obtained by the Applicant do not support the Applicant's proposed average service life for this account. Further, Mr. Pous claims that Mr. Watson placed too much importance on the steep drop observed in life tables for this account.²⁵⁹

²⁵⁵ TXU Gas Distribution, Initial Brief, p. 49.

²⁵⁶ *Id.*

²⁵⁷ TXU Gas Distribution, Ex. 47, p. 22.

²⁵⁸ TXU Gas Distribution, Ex. 47, p. 20.

²⁵⁹ City of Dallas, Ex. 29, p. 21.

(c) Examiners' Analysis and Recommendation

It is puzzling, given Mr. Watson's extensive rebuttal, that the City of Dallas did not address this issue in its Initial Brief or its Reply Brief. The City of Dallas, however, did not withdraw its allegations regarding this account and issues of fact were raised on Mr. Pous' direct case. Accordingly, the Examiners recommend that the Commission consider the issues raised regarding this Account.

The Examiners recommend that the average service life for this account be 45 years with a corresponding R1.5 *Iowa Curve*. Unlike the case for Account 386.3, Mains-Plastic, the Applicant has noted that nearly eighty percent of the top three statistical rankings outside the one hundred year band have a life of fifty years or less for this account.²⁶⁰ In addition, the information provided by the Applicant regarding the life estimation of the manufacturer clearly establishes that the average service life for valves may be as low as 25 to 30 years.²⁶¹

iii. Account 376.5: Mains-Steel Mill Wrapped/Bare

Issue: Should the average service life for Account 376.5 be 60 years or 70 years?

Examiners Recommendation: The average service life for this account should be 70 years.

Applicant	Intervenor	Examiners
60 year average service life with a corresponding R2 <i>Iowa curve</i>	\$128,485 adjustment based on the use of 70-year average service life with corresponding R1.5 <i>Iowa curve</i>	\$128,485 adjustment, as calculated by the City of Dallas, based on the use of 70-year average service life with corresponding R1.5 <i>Iowa curve</i>

This account is a mixture of bare steel, cast iron, and mill-wrapped steel mains.²⁶² The Applicant has proposed a 60-year average service life with a corresponding R2 *Iowa curve*. The City of Dallas recommends a 70-year average service life with a corresponding R1.5 *Iowa curve*.

²⁶⁰ TXU Gas Distribution, Ex. 47, p. 22.

²⁶¹ TXU Gas Distribution, Ex. 47, p. 22.

²⁶² TXU Gas Distribution, Ex. 47, DAW-R-6, p. 3.

(a) Applicant's Position

Mr. Watson states that the overall placement band for this account was reviewed and discounted because it indicated a life in the forty-year range. Instead, he started with the 1940 to 1999 placement band with 1980-1999 and 1990-1999 experience band. Visual curve matching indicated that a 60-year average service life for this account was reasonable.²⁶³ The Applicant produced over thirty-nine visual-curve-fitting analyses that demonstrated that a 60-year average service life for steel mains is the best fit.

Mr. Watson alleges that the City of Dallas has ignored the data that was provided concerning the asset mix of bare steel versus mill-wrapped steel. The Applicant argues that 3,789 miles of the 12,941 miles of steel main are bare steel and cast iron. This corresponds to 37% of the mileage being bare steel and cast iron. Since bare steel and cast iron mains are older and less expensive than mill wrapped steel, it will comprise a smaller percentage of the investment in this account. However, he asserts that in no way could the bare steel and cast iron investment be construed to represent only 1% of the investment in this account.²⁶⁴

He argues that, by relying solely on a 1960 placement band, Mr. Pous' analysis fails to recognize the first decade of investment in mill wrapped steel even though he acknowledges that the Applicant began installing mill wrapped steel in the 1950s. In addition, by failing to account for both the Applicant's first 10 years of investment in mill-wrapped steel that occurred in the 1950s and the amount of bare steel pipe that has yet to be retired, Mr. Pous' analysis reflects the wrong investment mix.²⁶⁵

(b) Intervenor's Position

Mr. Pous states that his recommendation is based upon a review of the observed life tables generated by the Applicant's actuarial analysis, review of various visual curve fittings, technological advancement, recognition of the current investment mix, and his experience and judgment. He points out that the Applicant has generated an extensive number of placement and experience bands in its analysis of this account. He complains, however, that the Applicant's analysis produced unrealistically short average service lives for its placement band analyses up through the 1950 band. For the 1960 placement band analysis, all of the Applicant's results indicate a significantly longer average service life, with many exceeding 100 years.²⁶⁶

He points out that the Applicant began installing mill wrapped steel pipe in the 1950s.²⁶⁷ Investments in the 1950s and before are, therefore, related to bare steel and cast iron pipe. Mr. Watson relies on visual curve fitting starting with the 1940 placement band. This band and the 1950 band contain the investment that the Applicant admits is being replaced and which will soon be eliminated. Mr. Pous believes that the reliance on placement bands that begin in 1940

²⁶³ TXU Gas Distribution, Ex. 47, DAW-R-6, p. 3.

²⁶⁴ TXU Gas Distribution, Ex. 47, p. 26.

²⁶⁵ *Id.*

²⁶⁶ City of Dallas, Ex. 29, pp. 23-24.

²⁶⁷ Mr. Pous clarifies that the wrapping protects the steel from degradation due to soil conditions.

and 1950 produce an invalid range of average service lives. He argues an average service life for this account should be selected based on statistical analysis of data after the 1960s. The Applicant's best fitting statistical results for the various 1960 placement band analyses yields an average service life ranging from eighty-eight years to ninety-nine years.²⁶⁸

(c) Examiners' Analysis and Recommendation

The Examiners agree with the City of Dallas that the average service life for this account should be 70 years with a corresponding R1.5 *Iowa curve*. For the 1960 placement band analysis, all of the Applicant's results indicate a significantly longer average service life than the 60 years proposed by the Applicant, with many exceeding 100 years. The Examiners agree that the reliance on placement bands that begin in 1940 and 1950 produce an invalid range of average service lives. The average service life for this account should be selected based on statistical analysis of data after the 1960s.

²⁶⁸ City of Dallas, Ex. 29, p. 24.

iv. Account 380: Services

(a) Applicant's Position

<p>Issue: Should the average service life for Account 380 be 33 years or 38 years?</p> <p>Examiners' Recommendation: The average service life for this account should be 33 years.</p>		
Applicant	Intervenor	Examiners
38-year average service life with a corresponding R2 <i>Iowa curve</i>	\$301,810 adjustment based on the use of 38-year average service life with corresponding L1.5 <i>Iowa curve</i>	\$301,810 as calculated by the City of Dallas, adjustment based on the use of 38-year average service life with corresponding L1.5 <i>Iowa curve</i>

The Applicant points out that the Intervenor failed to provide any closing statement to support Mr. Pous' proposed adjustment to this account.²⁶⁹ The Applicant argues that this account contains the property necessary to link the main to the customer's meter.²⁷⁰ Thus, the investment in this account includes smaller diameter pipe that is more susceptible to intervention by third parties. Mr. Watson cites as examples of this intervention pool installations and homeowners who install sprinkler systems.

In response to arguments raised by the City of Dallas in testimony, Mr. Watson argues that Mr. Pous has improperly discounted the level of steel investment reflected in this account and, as a result, fails to factor into his analysis approximately 30% of the assets that have yet to be retired into this account. He alleges that the flaw in Mr. Pous' analysis is exacerbated by his reliance on a single placement band to justify the average service life recommendation. By relying on a single placement band, Mr. Pous fails to consider placement bands that demonstrate the retirement pattern of both steel and plastic, which are also part of the investment mix in this account.²⁷¹

(b) Intervenor's Position

The City of Dallas alleges out that the Applicant performed dozens of actuarial analysis for this account but failed to recognize the logical trend in the results in conjunction with the

²⁶⁹ TXU Gas Distribution, Reply Brief, p. 49.

²⁷⁰ TXU Gas Distribution, Ex. 47, p. 27.

²⁷¹ TXU Gas Distribution, Ex. 47, p. 27.

investment mix in its selection process. The Applicant's most current placement band, beginning in 1960, produces results in the upper 30-year range rather than the lower 30-year range exhibited by placement band analyses from 1950 and earlier. Mr. Pous argues that Mr. Watson inconsistently and illogically relied on placement bands from the 1940 and 1950 through 1999. Finally, the Applicant's reliance on placement bands ranging from the 1930's, 40's, and 50's fails to recognize the expected life of plastic, versus bare steel and cast iron pipe, services. The Applicant's reliance on older placement bands has the impact of diluting the effects of better material and advancement in technologies.²⁷²

(c) Examiners' Analysis and Recommendation

The Examiners recommend that the average service life of 38 years with corresponding L1.5 *Iowa curve* be adopted for Account 380. The Applicant's most current placement band, beginning in 1960, produces results in the upper 30 year range rather than the lower 30 year range exhibited by placement band analysis from 1950 and earlier. The Examiners agree that the Applicant's reliance on placement bands ranging from the 1930's, 40's, and 50's fails to recognize the expected life of plastic, versus bare steel and cast iron pipe, services.

v. Account 398: Computer Equipment

In its Initial Brief, the City of Dallas proposed to make an adjustment to this account primarily because the account will soon be fully accrued.

(a) Applicant's Position

The Applicant, in its Reply Brief, points out that the City Dallas has offered no sponsoring witness, testimony or evidence concerning the calculation of, or basis for, this newly proposed adjustment. The Applicant argues that the Intervenor's argument is based not only on faulty assumptions, but is contrary to established ratemaking principles. First, the City of Dallas' adjustment is based on the faulty assumption that no new investment will be added to Account 398, even though additions to this account have averaged approximately \$1.3 million dollars annual over the last six years.²⁷³ Second, the Applicant argues that the proposals made by the City of Dallas would require TXU Gas Distribution to return depreciation expense that has not yet been collected.²⁷⁴

(b) Intervenor's Position

In its Initial Brief, the City of Dallas raised an objection to this account. The City of Dallas argues that the proposed rate is unreasonable based on the actual age of the investment. By the time rates in this case go into effect, TXU Gas Distribution will have recovered all but approximately \$213,000 of its entire investment assignable to the Dallas Distribution System. The Intervenor argues that the 1.38 year remaining life, as proposed by the Applicant, means that the investment will only be used and useful through the middle of 2001, based on Mr. Watson's

²⁷² City of Dallas, Ex. 29, pp. 26-27.

²⁷³ TXU Gas Distribution, Initial Brief, p. 58, citing to the testimony of Dane Watson at TXU Gas Distribution, Ex. 19 at Exhibit DAW-S-1, Appendix A at 160.

²⁷⁴ *Id.*

proposed life and curve combinations. This represents approximately a half-year after the rates in this case are scheduled to go into effect. Moreover, the City of Dallas alleges that TXU Gas Distribution admits that it would set the depreciation rate to zero once the account became fully accrued, and that, in fact, the account is going to retire fairly quickly.²⁷⁵

The City of Dallas proposes two alternatives. Under the first alternative, the Intervenor proposes a five-year amortization period after the rates in the case become effective. If the Applicant does not file another rate case for more than five years, then it should be ordered to accrue any over recovery and return the amount to customers in the future. This would result in an annual charge of approximately \$42,700, and produce a \$352,390 reduction to depreciation expense. The second alternative would be to remove the entire \$395,054 amount from the cost of service and add it to whatever level of rate case expenses surcharge and amortization period is ordered. The City of Dallas argues that this allows TXU Gas Distribution the recovery of the remaining approximate \$213,000 over whatever amortization period is selected for rate expense recovery.²⁷⁶

(c) Examiners' Analysis and Recommendation.

The Examiners recommend that the proposal of the City of Dallas be rejected and that the request of the Applicant with regards to this account be adopted. As is evident from the record, the Applicant has not indicated that it will not continue adding purchases to this account after a rate has been set.²⁷⁷ Further, the Examiners agree that the proposal of the City of Dallas would result in capturing a depreciation expense that has not been recovered.

d. Net Salvage

Issue: Should the average service life for Account 380 be 33 years or 38 years?		
Examiners' Recommendation: The average service life for this account should be 33 years.		
Applicant	Intervenor	Examiners
38-year average service life with a corresponding R2 <i>Iowa curve</i>	\$301,810 adjustment based on the use of 38-year average service life with corresponding L1.5 <i>Iowa curve</i>	\$301,810 as calculated by the City of Dallas, adjustment based on the use of 38-year average service life with corresponding L1.5 <i>Iowa curve</i>

²⁷⁵ City of Dallas, Initial Brief, p. 48. Citing to Tr. Vol. 2, p 224.

²⁷⁶ City of Dallas Initial Brief, p. 49.

²⁷⁷ TXU Gas Distribution, Ex. 19 at Exhibit DAW-S-1, Appendix A at 160.

The Applicant and the City of Dallas agree that net salvage is the salvage value of retired property, less the cost of removal.²⁷⁸ If an asset's salvage value exceeds the cost of removal, the net salvage value is positive, which results in a decrease in depreciation rates. If the net salvage is negative, it creates an increase in depreciation rates. A zero net salvage implies that the salvage value is equal to the cost of removal. As observed by NARUC, determining a reasonably accurate estimate of the average or future net salvage is "not an easy task; estimates can be the subject of considerable discussion and controversy"²⁷⁹

The City of Dallas takes issue with the net salvage value proposed by the Applicant for the Distribution functional group. The principal source of the controversy in this case is the Applicant's decision to remove certain terminations of property from the data used in calculating net salvage. TXU Gas Distribution has removed all outliers, sales, and reimbursed retirements from its net salvage analysis.²⁸⁰ An outlier retirement is one that does not fall within the normal distribution of the sample data.²⁸¹

i. Applicant's Position

Mr. Watson notes that two transactions were classified as outliers. One was a "buy back" from General Motors for defective transportation equipment. The other was a sale of a communication tower that was valued specifically for where it was located.²⁸² The transaction with General Motors was valued at \$974,000 and the sale of the communications tower was valued at \$3,424.27.²⁸³ Mr. Watson considered that both of these transactions were very unusual and unlikely to reoccur. Thus, he removed them from the net salvage analysis. Mr. Watson also removed sales of plant facilities from the analysis of net salvage. He argues that TXU Gas Distribution is not in the business of selling assets. Presumably, including those sales would distort the net salvage analysis. Thus, they were removed as well.²⁸⁴

As explained by Mr. Watson, reimbursed retirements involve reimbursements for relocations and are payments for new property being installed. He argues that reimbursed retirements should not be accounted for as part of the salvage value of retired property. He explains that reimbursed retirements of plant are not representative of normal disposal of plant and should be eliminated from the analysis. He cites a study by Wolf and Fitch for the proposition that usually reimbursed retirements should not be included in the analysis to estimate the life and salvage of property whose original investment is recovered through depreciation accruals. Finally, he points out that NARUC suggests, depending on the accounting treatment for reimbursements related to retired property, that the analyst may need to remove such plant

²⁷⁸ City of Dallas, Ex. 29, p. 28; & TXU Gas Distribution, Ex. 19, DAW-S-1, p. 15.

²⁷⁹ Examiners Ex. 3, p. 157.

²⁸⁰ TXU Gas Distribution, Ex. 19, p. 10.

²⁸¹ TXU Gas Distribution, Ex. 19, DAW-S-1, p. 16.

²⁸² TXU Gas Distribution, Ex. 47, pp. 35-36.

²⁸³ Tr. Vol. 3, pp. 197-198.

²⁸⁴ TXU Gas Distribution, Ex. 47, p. 32.

from the database. NARUC concludes that consistent treatment is the rule. He claims that his depreciation study is consistent in retaining or removing transactions for both life and salvage analysis.²⁸⁵

Mr. Watson raises several issues regarding Mr. Pous' analysis. First, he alleges that Mr. Pous has failed to provide any detail regarding the claim that the Applicant has failed to perform a proper evaluation phase in its depreciation study. Second, he suggests that Mr. Pous' claim that the historical data should not be adjusted is undercut by all authoritative sources that address this issue. Third, he alleges that Mr. Pous fails to understand the Applicant's accounting practices with respect to the booking of reimbursements. Fourth, any parallels to TXU LSP are invalid because TXU LSP does not have Distribution plant similar to the DDS and, finally, Mr. Pous did not perform any economy-of-scale analyses.²⁸⁶

Mr. Watson points out that the AGA/EEI statistics in Mr. Pous' own workpapers show the average net salvage used by gas utilities across the country for the distribution function is negative 42.49%. He points out that Deloitte and Touche, using a slightly different approach came to the exact same conclusion as the Applicant, that negative 30% net salvage is appropriate.²⁸⁷ Mr. Watson argues that sales are premature retirements of plant that should be removed from historical data if they are not representative of terminal retirements.²⁸⁸ Mr. Watson also argues that reimbursed retirements should also be removed.

He argues that Mr. Pous has not provided any data that demonstrates that reimbursed retirements are likely to recur. Since the last rate, case the only reimbursements received by the City of Dallas are related to the Dallas Area Rapid Transit construction of the light rail system. He points out that even Mr. Pous acknowledges that this construction has been substantially completed. Therefore, the historical data does not suggest any additional DART reimbursement or any other project that would cause reimbursement by the City of Dallas.²⁸⁹ He argues that the Public Utility Commission in Docket No. 11735 did not address this issue, despite Mr. Pous' assertion, and the Railroad Commission of Texas in GUD No. 8976 adopted the net salvage proposed by the applicant, thus accepting its proposed methodology.

He argues that the Applicant books reimbursements related to relocation in Account 108, as required by NARUC. There is nothing in the record to support Mr. Pous' conclusion that reimbursements are not booked to Account 108. Mr. Pous' allegations are based on the incorrect assumption that the Applicant books reimbursements to Account 101.²⁹⁰

ii. Intervenor's Position

By including the outliers, sales, and reimbursed retirements, the City of Dallas concludes that the appropriate net salvage value for the Distribution Plant Function should be zero (0). Mr.

²⁸⁵ TXU Gas Distribution, Ex. 19, pp. 11-12.

²⁸⁶ TXU Gas Distribution, Ex. 47, p. 30.

²⁸⁷ *Id.*

²⁸⁸ TXU Gas Distribution, Ex. 47, p. 31.

²⁸⁹ TXU Gas Distribution, Ex. 47, p. 33.

²⁹⁰ TXU Gas Distribution, Ex. 47, p. 35.

Pous claims that the actual accumulation level of net salvage ranges from a positive 61% in 1999, to a negative 25.56% after three years, to a negative 0.65% after 10 years.²⁹¹

Mr. Pous alleges that the Applicant relied exclusively on historical data without providing a “proper” evaluation phase.²⁹² The City of Dallas argues that Mr. Watson has confused the outlier retirement concept. Mr. Pous takes aim at Mr. Watson’s statement that an outlier retirement is “one that does not fall within the normal distribution patterns of the sample data.”²⁹³ He argues that Mr. Watson goes astray by mixing statistical measures with non-statistical concepts. He suggests that Mr. Watson does not define “normal variations” or “normal disposal.”²⁹⁴

Mr. Pous argues that TXU Gas Distribution has improperly excluded sales. He notes that NARUC, in its publication, *Public Utility Depreciation Practices*, states that “[g]enerally, if transfers or sales of plant have contributed significantly to realized salvage, and such transactions are considered unrepresentative of the future, these transactions should be eliminated from the data.” Thus, the general rule expressed by NARUC is that transfers or sales are included in the calculation of net salvage, unless such transactions are considered unrepresentative of the future.

He claims that Mr. Watson has treated reimbursed retirements inconsistently. On one hand, Mr. Watson has removed reimbursed retirements from the calculation of net salvage; on the other hand, he has included them in his analysis of average service lives.²⁹⁵ Mr. Pous notes that, up until 1996, the Applicant accounted for reimbursed retirements as net salvage. Further, he argues that NARUC rules require that reimbursed retirements be included in the calculation of net salvage.²⁹⁶ Finally, Mr. Pous states that, in Docket No. 11735, a Texas Utilities Electric Company case, the PUC found that reimbursed retirements must be included in a net salvage analysis.

iii. Examiners’ Analysis and Recommendation

The Examiners recommend that TXU Gas Distribution’s proposed net salvage value of a negative 30% be adopted. As pointed out by the Applicant, the AGA/EEI noted that a negative 42.49% is reasonable for this function. NARUC pointedly states that it is frequently the case that net salvage for a class of property is negative, that is, that the cost of removal exceeds gross salvage. NARUC goes on to state the following observation:

The circumstance has increasingly become dominant over the past 20 to 30 years; in some cases negative net salvage even exceeds the original cost of plant. Today few utility plant categories experience positive net salvage; this means that most

²⁹¹ City of Dallas, Ex. 29, p. 39.

²⁹² City of Dallas Ex. 29, pp. 30-31.

²⁹³ City of Dallas, Ex. 29, p. 38, quoting from TXU Gas Distribution, Ex. 19, p. 11.

²⁹⁴ City of Dallas, Ex. 29, p. 39.

²⁹⁵ City of Dallas, Ex. 29, pp. 31-32.

²⁹⁶ City of Dallas, Ex. 29, p. 30.

depreciation rates must be designed to recover more than the original cost of plant.²⁹⁷

Mr. Pous testified that negative net salvage is not unusual:

Just like you can have negative net salvage. Years ago Commissioners, when a company would propose a negative net salvage, they would say, you can't have a negative net salvage. You know what? Nowadays a lot of places have negative net salvage. It is just when you see it for the first time, it may be a little bit harder to comprehend.²⁹⁸

An exhibit attached to Mr. Pous' testimony reveals that a 1995 study prepared by Deloitte & Touche compared net salvage analyses including reimbursements and excluding reimbursements. The study concluded that, with reimbursements, a net salvage value of negative 24 percent was reasonable; a net salvage value of negative 27% was reasonable if one excluded reimbursed retirements.²⁹⁹ Mr. Pous testified that his own analysis produced a result that ranged from a positive value to a negative 25.26%.³⁰⁰ The Examiners conclude that there is insufficient evidence in the record to support the calculation of a zero net salvage value.

Further, NARUC Uniform System of Accounts (USOA) does not resolve the issue. The City of Dallas provided an analysis of the definitions and concluded that the definition of gross salvage provides for no exception for reimbursed retirements.³⁰¹ However, NARUC rules do not explicitly preclude the treatment of reimbursed retirements proposed by the Applicant. Indeed, in Public Utility Depreciation Practices, NARUC states that reimbursements and the corresponding salvage should either both "be included"³⁰² or excluded from the depreciation study. The accounting for removals should be analyzed to identify the apportionment of monies received among an offset to new construction, gross salvage, and cost of removal."

The Examiners agree that the general rule regarding sales is that they be included in the analysis. Further, the Examiners agree that unusual sales should be removed from the analysis because it distorts the finding of the study. There is, however, no evidence in the record to suggest which sales should be included and what impact that would have on net salvage. Accordingly, the Examiners find that a negative 30% net salvage value is reasonable.

²⁹⁷ Examiners Ex. 3, p. 158. NARUC goes to point out that the predominance of this circumstance is one reason why some utility commissions have switched to current-period accounting for gross salvage and, particularly, cost of removal. Such a proposal has not been made in this case.

²⁹⁸ Tr. Vol. 5, pp. 136-137.

²⁹⁹ City of Dallas, Ex. 29, Exhibit JP-5.

³⁰⁰ City of Dallas, Ex. 29, p. 39.

³⁰¹ A similar conclusion was reached by the Examiner in GUD No. 8976. Revised PFD, p. 83. The Railroad Commission of Texas rejected the Examiners' recommendation and adopted TXU LSP proposal for net salvage.

³⁰² Examiners Exhibit 3, p. 31.

- e. Clearing Accounts: Fully Accrued Depreciation
- i. Expense Adjustments

Issue: Should the level of clearing account depreciation expense be adjusted?

Examiners' Recommendation: No. The Applicant has demonstrated that the accounts at issue were not clearing accounts during the test year.

Applicant	Intervenor	Examiners
No adjustment	\$246,000 adjustment.	No adjustment

Clearing accounts are special accounts which serve to accumulate costs temporarily until the costs can be allocated to other related accounts.³⁰³ The City of Dallas argues that expenses related to three clearing accounts should be removed from operations and maintenance expenses proposed in this case: transportation equipment, power-operated equipment, and communication equipment.

(a) Applicant's Position

In response to the adjustments proposed by the City of Dallas, Mr. Watson argues that the clearing account practice ceased in 1998 and that there were no depreciation expense charges to clearing accounts in 1999. Mr. Watson points out that these accounts were not clearing accounts during the test year. Thus, he argues that the Applicant did not rely on a test year level of operations and maintenance expenses that included depreciation associated with these clearing accounts.³⁰⁴

(b) Intervenor's Position

The City of Dallas explains that the Applicant has recognized the over depreciated nature of certain accounts and has requested that no further depreciation be taken for these accounts.

³⁰³ Examiners' Exhibit 3, *Public Utility Depreciation Practices*, p. 49. NARUC provides the following example: If the accounting objective is to assign all motor vehicle expense to functions and activities supported by the use of motor vehicles, the costs associated with motor vehicles are first accumulated in a motor vehicle expense clearing account and then allocated to the functions and activities supported by motor vehicles based on a usage factor. A motor vehicle expense clearing account is used because the expenses associated with motor vehicles cannot be assigned to the final accounts at the time incurred. Thus, if motor vehicles support both the maintenance of existing assets and the construction of new ones, part of the motor vehicle costs would be cleared to maintenance expense and part would be capitalized as a cost of new assets being constructed.

³⁰⁴ TXU Gas Distribution, Ex. 47, pp. 43-44.

However, the Applicant has not made any cost-of-service adjustment associated with this proposal. Mr. Pous argues that, once the Applicant determined that no further depreciation should be associated with these accounts, TXU Gas Distribution should have made an adjustment to the operations and maintenance expense included in this case. The City of Dallas argues that the Applicant's cost of service reflects approximately \$246,000 of clearing accounts related to depreciation expense for these accounts.³⁰⁵

(c) Examiners' Analysis and Recommendation

The Examiners recommend that the Intervenor's proposed adjustment be rejected. The Applicant has clarified that these accounts were not clearing accounts during the test year. Accordingly, no adjustment is necessary.

ii. Retroactive Rate Issues

Issue: Should a retroactive adjustment to depreciation be made to TXU Gas Distribution's treatment of fully accrued accounts?

Examiners' Recommendation: No. TXU Gas Distribution's treatment of fully accrued accounts does not violate the Texas Utilities Code.

Applicant	Intervenor	Examiners
No adjustment	\$722,259 adjustment to rate base.	No adjustment

The City of Dallas argues that the Applicant has exceeded its authority by changing the depreciation rate to zero for the three clearing accounts.³⁰⁶ On each of these accounts, the Applicant has suspended depreciation accruals. Accruals were suspended in 1999 for the transportation and power-operated equipment accounts, and in 2000 for communication equipment.³⁰⁷

(a) Applicant's Position

Mr. Watson argues that the Applicant must adhere to Generally Accepted Accounting Principles (GAAP). GAAP rules state that the Applicant should not continue to accrue depreciation expense on accounts that are fully depreciated. He argues that any suggestion to

³⁰⁵ City of Dallas, Ex. 29, pp. 77-79.

³⁰⁶ City of Dallas, Ex. 29, p. 80 & Ex. 30 pp. 1-8.

³⁰⁷ TXU Gas Distribution, Ex. 47, p. 45

require continued accrual would be in violation of GAAP. Furthermore, he explains that no additional depreciation expense should be recovered to correct under-accrued accounts, nor should depreciation expense be refunded on those accounts that are over-accrued. Any over/under recovery will be carried forward and the net (if any) of the original investment less net salvage less any accumulated reserve will begin to be recovered under the new and future rate structure.³⁰⁸

Finally, in response to an assertion by Mr. Pous that negative depreciation rates are supported by industry practice, Mr. Watson states that no natural gas utility LDC or transmission company shows negative depreciation rates in the 1997-1998 EEI/AGA Survey of Depreciation Statistics Report. He concludes that Mr. Pous' clearing account adjustment is inconsistent with industry practice and is based on an erroneous assumption concerning the manner in which the Applicant handled clearing accounts during the test year.³⁰⁹

(b) Intervenor's Position

The City of Dallas argues that the Applicant does not have the authority to unilaterally change its depreciation rates and that any "true-up" mechanism that may have existed was eliminated by the Applicant. Mr. Pous explains that depreciation expense is obtained by multiplying the gross plant balance by the approved depreciation rate. The depreciation expense is then booked into the Account 108. This account is an offset to rate base. He further clarifies that in the establishment of revenue requirements in a rate case, a utility company is allowed to earn a reasonable return on rate base. If a utility can unilaterally change depreciation rates, it destroys the only "true-up" mechanism in the depreciation process. Further, it will artificially and inappropriately increase rate base.

(c) Examiners' Analysis and Recommendation

The Examiners recommend that no adjustment be made for the clearing accounts. The statute cited by Mr. Pous states that the Railroad Commission of Texas "shall establish proper and adequate rates and methods of depreciation, amortization, or depletion for each class of property of a gas utility or municipally owned utility." TXU Gas Distribution's treatment of fully-accrued accounts does not violate this statute. The statute is silent on how to treat fully-accrued accounts. The statute does not address any "true-up" mechanism that may, or may not, exist. If the adjustment proposed by the City of Dallas is made, then a retroactive adjustment must be made for any new investment made after rates are set in this case. Rates set in this case may or may not be adequate to recover any new expenditures. The correction occurs when a new rate is set. Finally, the Examiners agree with Mr. Watson that there is no evidence in the record that the Applicant has not charged the rate it was authorized to charge.

3. Pensions, Benefits, and OPEB's: SFAS-106.

In December 1990, the Financial Accounting Standards Board adopted Statement of Financial Accounting Standard 106 (SFAS-106), altering the way in which companies accounted

³⁰⁸ TXU Gas Distribution, Ex. 47, p. 46.

³⁰⁹ TXU Gas Distribution, Ex. 47, p. 48.

for other post-employment benefits (OPEB) for fiscal years beginning in 1992.³¹⁰ Before SFAS-106, firms accounted for these benefits on a “pay as you go” or cash basis, recognizing them when the costs were paid rather than when the firm received the services for which the benefits were compensated. SFAS-106 adopts an accrual method, requiring recognition of OPEB costs as they are earned by current employees.³¹¹ It was determined that an actuarially-derived level may be more appropriate for financial reporting purposes because the actual current level of expense may not be representative of normalized long term costs for such items.³¹² TXU Gas Distribution adopted SFAS-106 in 1993.³¹³ The Applicant’s proposed expenses requirement for SFAS-106 is \$955,350.³¹⁴ The City of Dallas alleges that two adjustments are required to the SFAS-106 expense: The first is a reduction in the medical cost trend. The second relates to the recognition for ratepayers of the benefits lost due to the Applicant’s alleged failure to establish an external fund.³¹⁵

a. Medical Cost Trend.

Issue: Should the medical trend used in the SFAS 106 be 1.5% or 5%?		
Examiners’ Recommendation: A 5% medical cost trend is well below the industry average of 7%.		
Applicant	Intervenor	Examiners
5% medical cost trend	\$115,359 adjustment based on the use a 1.5% medical cost trend	5% medical cost trend

i. Applicant’s Position

Barbara Myers testified on behalf of TXU Gas Distribution regarding SFAS-106. She testified that SFAS-106 changed the accounting rules for post-retirement benefits, other than pensions, from a cash basis of accounting to an accrual method of accounting.³¹⁶ Upon the adoption of SFAS-106, actuarial calculations were performed to determine the liability that existed at the time of adoption of the new standard, as well as current period expense to be accrued for active employees.³¹⁷ Ms. Myers testified that the liability at initial adoption is defined as the “transition obligation.”

³¹⁰ The “other” is intended to exclude pension benefits; what is left generally consists of retirees’ life insurance and medical and dental care benefits. *Southwestern Bell Telephone Co. v. FCC*, 28 F.3rd 165 (D.C. Cir. 1994).

³¹¹ *Id.*

³¹² *Id.*

³¹³ TXU Gas Distribution, Ex. 10, p. 21.

³¹⁴ City of Dallas, Ex. 29, p. 83.

³¹⁵ City of Dallas, Initial Brief p. 50.

³¹⁶ *Id.*

³¹⁷ *Id.*

SFAS-106 allowed companies to elect to either amortize the transition obligation over a period not greater than twenty years or charge the total expense upon adoption of SFAS-106. TXU Gas Distribution elected to amortize the transition obligation over a twenty-year period. That twenty-year period commenced in 1993.³¹⁸ TXU Gas Distribution maintains that the transition obligation was recorded as a regulatory asset consistent with SFAS-71.

TXU Gas Distribution adjusted the level of expense annually to reflect the results of the actuarial valuations. Ms. Myers testified that the valuation is performed by the actuarial firm of William H. Mercer.³¹⁹ The actuarial valuation is based on employee payroll and other employee and financial data provided by TXU Gas Distribution. In response to the testimony of Mr. Pous, F. Pierce Noble, a Worldwide Partner with William M. Mercer testified on behalf of TXU Gas Distribution.

Specifically, he responded to Mr. Pous' allegation that the medical trend assumption used to compute the SFAS-106 expense should be reduced from 5% to 1.5%. He testified that a 5% medical trend assumption was supportable and, in fact, lower than the average medical trend assumption of 7% used by major corporations, including several utilities, in determining the SFAS 106 expense.³²⁰ He testified that a survey prepared by Spencer Research Reports lists the assumptions used by seventy-two publicly-held companies (including several utilities) in the determination of their SFAS-106 expense. The average initial medical trend assumption used by the companies reported in the survey was over seven percent. He testified that William M. Mercer's own study found that the medical trend assumption reported by 238 companies for the initial year was 7.16%.³²¹

ii. Intervenor's Position

Mr. Pous testified on behalf of the City of Dallas regarding SFAS-106. Mr. Pous recognized that the actuarially derived level is greater than the actual current expense level.³²² Mr. Pous argues that the Applicant's most recently completed SFAS-106 actuarial report was not relied upon. He argues that the values booked during 1999 supposedly came from incomplete actuarial reports. He testified that the Applicant failed to provide the underlying documentation for the establishment of its 1999 SFAS-106 requirements in its work-papers, testimony, exhibits, or depositions. He maintains that Ms. Myers could not identify the specific amount in the costs of service for SFAS expense nor could she identify from what documentation the figures had been obtained.

He testified that the estimated medical cost inflation rate is normally assumed to be the most significant assumption in the establishment of overall SFAS 106 costs.³²³ Since the implementation of SFAS 106 in 1993, the Applicant has relied on a series of assumptions

³¹⁸ *Id.*

³¹⁹ Myers, 22

³²⁰ TXU Gas Distribution Ex. 12, p. 3.

³²¹ TXU Gas Distribution Ex. 12, p. 8.

³²² *Id.*

³²³ City of Dallas, Ex. 29, p. 85.

beginning with a 12% annual escalation level. Currently, the Applicant has assumed a 5% medical cost escalation rate for the current period forward. Mr. Pous points out that the Applicant's most recent complete actuarial analysis states "[I]n general, the initial rate is set based on recent plan experience and other similar types of recent industry experience. If recent plan experience is not available, industry averages for companies with similar plans and population are typically used."³²⁴

Mr. Pous alleges that, over the period 1993 through 1999, the Applicant has experienced an approximate 1.8% annual compounded increase in medical costs on an average cost-per-member basis. However, during this period the Applicant, through its outside actuary, has relied on inflation rates as high as 12% per year and never lower than 4.5%. Mr. Pous argues that the outside actuary's claimed basis for establishing the medical cost trend is false.³²⁵ There is, he avers, no actual basis provided by the Applicant, in any format, which justifies the significant departure from many years of actual plan experience at issue in this proceeding.

Mr. Pous is recommending a 3.5% reduction in the medial cost trend assumption. He argues that this level of reduction is required to reflect the Applicant's actual historic plan experience and to recognize significant overstatement of medical cost trends reflected in the Applicant's prior actuarial analysis. Mr. Pous made his adjustment as follows. First, he quantified the impact on SFAS 106 net periodic cost due to a 1% change in the medical cost trends. This information was taken from the most recent SFAS 106 actuarial analysis. Next, he multiplied the impact due to a 1% change times the 3.5% point reduction he is recommending. The combined impact was then applied to the SFAS 106 expense level in the cost of service. This results in a \$115,359 reduction in the Applicant's revenue requirement request.³²⁶

iii. Examiners' Analysis and Recommendation

The Examiners recommend that the Applicant's proposed medical trend of 5% be adopted. The Examiners agree that a 5% medical trend assumption was supportable and, in fact, lower than the average medical trend assumption of 7% used by major corporations, including several utilities, in determining the SFAS-106 expense.³²⁷ He testified that a survey prepared by Spencer Research Reports lists the assumptions used by seventy-two publicly held companies (including several utilities) in the determination of their SFAS-106 expense. The average initial medical trend assumption used by the companies reported in the survey was over seven percent. He testified that William M. Mercer's own study found that the mean medical trend assumption reported by 238 companies for the initial year was 7.16%.³²⁸

³²⁴ *Id.*

³²⁵ City of Dallas Ex. 29, p. 86.

³²⁶ City of Dallas Ex. 29, p. 87.

³²⁷ TXU Gas Distribution Ex. 12, p. 3.

³²⁸ TXU Gas Distribution Ex. 12, p. 8.

b. External Fund

Issue: Should an adjustment be made for TXU Gas Distribution's decision not create an external fund?

Examiners' Recommendation: No. A retroactive adjustment for TXU Gas Distribution's decision not to create an external fund should not be made. However, the Examiners recommend that the Applicant be required to establish an external fund.

i. Applicant's Position

Mr. Noble testified that he did not see any reason why an external fund should have been established. SFAS 106 does not require such a fund. The 1994 rate agreement for the Dallas Distribution System did not require such fund.³²⁹ Furthermore, he does not agree with Mr. Pous' calculation of a rate base offset. He notes that, if the 1994 rate agreement for the Dallas Distribution System had included a provision requiring funding, it probably would have required the funding of the dollar amount of retiree medical expense allowed in the rates. He believes that the amount included in the rates were only about 48% of the SFAS-106 expense. He argues that Mr. Pous' calculation is prefaced on funding the full SFAS-106 expense. Thus, if the 1994 rate agreement for the DDS had required funding, the amount that TXU Gas Distribution would have been required to fund would have been less than the DDS's share of the medical claims paid to the retirees. Consequently, he argues, there would not have been any accumulation of assets and any rate base offset would be zero. Finally, he notes that Mr. Pous has guessed as to the amount of the claims that would have been paid from these assets for the years 1993 through 1996. Such data is not available.³³⁰

ii. Intervenor's Position

Mr. Pous argues that the Applicant should establish an external fund for SFAS-106 requirements. He points out that the Applicant takes the position that it is not required by law to externally fund SFAS-106 obligations. The Applicant takes this position in spite of the fact that the Commission has ordered the Applicant's affiliate, TXU LSP, to establish an external SFAS-106 fund in GUD No. 8664 and that the Applicant's electric affiliate has been ordered to establish an external fund for SFAS-106 requirements by the PUC.

³²⁹ TXU Gas Distribution, Ex. 12, p. 10.

³³⁰ *Id.*

He recommends that a minimal level of rate base offset be calculated for the Applicant's alleged failure to establish an external fund associated with SFAS-106 requirement. Further, Mr. Pous recommends that the Commission order the Applicant to perform a study to quantify the precise over collection and present alternative levels of earning on such over collections that would have been available for the benefit of customers had an external fund been established at the outset of implementation of SFAS-106.³³¹

iii. Examiners' Analysis and Recommendation.

The Examiners recommend that no adjustment be required. The City of Dallas did not require that an external fund be established in the last rate case. Requiring the Applicant to pay an adjustment for not establishing an external fund that the City of Dallas could have required in 1994 is unreasonable and may result in retroactive ratemaking. In addition, the Examiners find that a study to quantify the over collection and present alternative levels of earnings is not necessary. However, the Examiners do recommend that the Railroad Commission of Texas require that the Applicant establish an external fund.

4. Affiliate Issues

Issue: Has TXU Gas Distribution met the standard regarding affiliate transactions.

Examiners' Recommendation: Yes. The Applicant has demonstrated that its affiliate expenditure were reasonable and necessary and that the price charged was not higher than the prices charged to other affiliate or to non affiliated persons.

The Applicant and the Intervenor agree that the applicable statutory standard is codified at Tex. Util. Code Ann. § 104.055(b):

In establishing a gas utility's rates, the regulatory authority may not allow a gas utility's payment to an affiliate for the cost of a service, property, right, or other item or for an interest expense to be included as capital cost or as expense related to gas utility service except to the extent that the regulatory authority finds the payment is reasonable and necessary for each item or class of items as determined by the regulatory authority. That finding must include:

- (1) A specific finding of the reasonableness and necessity of each item or class of items allowed, and

³³¹ City of Dallas, Ex. 29, p. 89.

- (2) A finding that the price to the gas utility is not higher than the prices charged by the supplying affiliate to its other affiliates or divisions or to a nonaffiliated person for the same item or class of items.

Therefore, payments to affiliated interests are presumed excluded from a utility's rate base or operating expenses unless the utility presents evidence and the Commission finds that (1) each item or class of item is reasonable and necessary, and (2) the price charged is not higher than that charged to other affiliates, divisions, or unaffiliated entities.³³²

TXU Gas Distribution, which is an unincorporated division of TXU Gas Company, receives affiliate services from the following entities: TXU Business Services, TXU Electric, and TXU Pipeline Services. TXU Business Services, TXU Electric, and TXU Gas Company are incorporated; however, TXU Pipeline Services is an *unincorporated* division of TXU Gas Company.

a. Applicant's Position

Stephen Ragland, Management Support Manager of TXU Business Services, testified on behalf of the Applicant. He explained that TXU Business Services provides accounting, financial, information technology, personnel, procurement, environmental, real estate, corporate secretarial, facilities management, and other services to TXU Gas Distribution.³³³ For the test year ending December 31, 1999, TXU Business Services charged TXU Gas Distribution \$29,249,792.86.³³⁴ Of that amount, \$4,989,809.94 was assigned to the Dallas Distribution System. Mr. Ragland identified each project, or class of expenditure, described it and identified the billing methodology.³³⁵ Mr. Ragland testified that market studies are conducted to test the reasonableness of amounts billed.³³⁶ In addition, Mr. Ragland testified that he reviewed the cost assignment methodology or methodologies used for each activity, or project, and determined in each instance that the cost assignment methodology was reasonable and that the assigned amounts reasonably reflect the actual cost of the services provided to each particular subsidiary or division.³³⁷

Randall T. Mueller, Corporate Accounting Manager—Electric and Gas Utilities, TXU Business Services, testified that TXU Electric and TXU Gas Distribution combined certain electric and gas business functions after the August 1997 merger of TXU Corporation and TXU Gas Company.³³⁸ Mr. Mueller described the items or classes of services performed for TXU Gas Corporation as follows: Operating and maintaining the gas distribution system, developing and maintaining community and municipal relations, managing the process of adding new customers, managing business and economic development programs, reading customer meters, performing

³³² *City of Amarillo v. Railroad Comm'n*, 894 S.W.2d 491 (Tex. App.—Austin 1994, writ denied).

³³³ TXU Gas Distribution, Ex. 13, p. 3.

³³⁴ TXU Gas Distribution, Ex. 14, p. 31.

³³⁵ Id at pp. 7-27.

³³⁶ TXU Gas Distribution, Ex. 13, pp. 18-19 & Tr. Vol. 6, p. 48.

³³⁷ TXU Gas Distribution, Ex. 13, p. 25.

³³⁸ TXU Gas Distribution, Ex. 16, p. 4.

customer collections, operating customer information call centers, and preparing and processing customer billings.³³⁹

Mr. Mueller testified that there were two basic billing methodologies regarding charges from TXU Electric: the Automated Timekeeping System (ATS) and the Average Unit Billing System (AUB). ATS is a computerized time reporting application used to record actual time worked on gas and electric projects. AUB is a process utilized to equitably assign operations support services costs incurred by TXU Electric for work performed for both the electric operations and gas operations. It was used to assign costs related to the following activities: reading customer meters, performing customer collections, operations of customer information call centers, and preparing and processing customer billings. The methodologies used for assigning operations support services costs through the AUB process are based on percentages of the following statistical data: number of customer meters read, number of collector bills printed, number of customer calls received; and number of customers.³⁴⁰ During the test year updated through December 31, 1999, the total costs charged by TXU Electric to TXU Gas Distribution through ATS for the entire gas distribution systems was approximately \$52.8 million. The total costs charged by TXU Electric to TXU Gas Distribution through AUB for the entire gas distribution system was approximately \$29.8 million.³⁴¹ Finally, TXU Pipeline Services charged TXU Gas Distribution approximately \$400,000.

Mr. Dixon also testified regarding affiliate expenditures. He also explained that TXU Gas Distribution shares services with TXU Electric for combined electric and gas functions performed by TXU Electric employees. He explained that TXU Pipeline Services provides gas measurement and laboratory services to TXU Gas Distribution and that TXU Gas Distribution also incurs operating costs relating to services provided by TXU Business Services. He further testified that the services provided by these affiliates was integral to TXU Gas Distribution's provision of safe and reliable service.³⁴²

Mr. Dixon also explained that, as services are shared with TXU Electric are provided within the Distribution Business Unit, he exercises oversight over the level of expense incurred prior to the assignment of such expense to TXU Gas Distribution in order to ensure that the level of expense is both reasonable and necessary. He concludes that all charges to TXU Gas Distribution by TXU Electric, TXU Pipeline Services, and TXU Business Services are no higher than charges for the same or similar service to other affiliates or third parties.³⁴³

b. Intervenor's Position

During the hearing, the Intervenor did not specifically challenge the reasonableness of specific charges from an affiliate to the Applicant. In its Initial Brief, the City of Dallas suggests that the Applicant has not met the affiliate transaction standard set out in TUC 104.055(b). The Intervenor focuses its analysis on an examination of the documents provided by the Applicant at

³³⁹ TXU Gas Distribution, Ex. 16, p. 4.

³⁴⁰ TXU Gas Distribution, Ex. 16, pp. 6-12.

³⁴¹ TXU Gas Distribution, Ex. 17, p. 3.

³⁴² TXU Gas Distribution, Ex. 5, p. 17.

³⁴³ *Id* at 18.

the request of the Examiners. The Examiners questioned the Applicant's witnesses regarding \$117,659 in rate case expenditures and \$877 in expenditures for an expense item referenced as Maynard Ranch. The Intervenor also references certain nonrecurring expenditures and a correction made by the Applicant to its billing records. The City of Dallas, alleges adjustments made by the Applicant during the Examiners' examination and the alleged nonrecurring expenditures preclude the Commission from making the findings required under TUC § 104.055(b). Thus, by implication, the City Dallas argues that all affiliate expenditures must be disallowed.

c. Examiners' Analysis and Recommendation

The Examiners recommend that, except for Y2K expenses discussed below, the affiliate expenditures reported by TXU Gas Distribution be approved. TXU Gas Distribution's original filing contained the items or class of items charged by affiliates of the Applicant. Mr. Ragland described the expenditures and billing methodology employed by TXU Business services. A detailed schedule was provided to the Examiners itemizing expenditures from TXU Business Services to TXU Gas Distribution.³⁴⁴ The Applicant detailed the expenditures for each class or item. In addition, after a specific request from the Examiners the Applicant provided detailed information, that had been provided to the Intervenor, regarding the assignment of costs to the Dallas Distribution System.³⁴⁵ Likewise, Mr. Mueller described each class of expenditure from TXU Electric and provided a schedule detailing the expenditures from TXU Electric to TXU Gas Distribution. Finally, Mr. Mueller provided a breakdown of costs to the Dallas Distribution System for those services.³⁴⁶ Further, the Examiners do not agree with Mr. Pous' suggestion that a rate related audit be required.

5. Disallowed Expenses

Issue: Should Y2K and merger related expenses be disallowed?

Examiners' Recommendation: Yes. The Applicant has failed to establish that Y2K and merger related expenses are recurring.

a. Y2K Expenses

TXU Gas Distribution was billed \$369,654 for Y2K expenses during the test year.³⁴⁷ Of that amount, \$63,386 was assigned to the Dallas Distribution System.³⁴⁸ In GUD No. 8976, the Commission decided that \$483,177 for Y2K services by TXU Business Services to TXU LSP should be disallowed as a non-recurring expense. The Commission found that "TXU LSP failed to document the amount of historical Y2K costs that will recur in the form of future technology

³⁴⁴ TXU Gas Distribution, Ex. 14.

³⁴⁵ TXU Gas Distribution, Ex. 33 and Examiners Exhibit 3.

³⁴⁶ Examiners' Ex. 4.

³⁴⁷ TXU Gas Distribution, Ex 14, p. 29.

³⁴⁸ TXU Gas Distribution, Ex. 33, p. 7.

services, and it failed to produce any evidence of the cost of future projects.”³⁴⁹ TXU Gas Distribution likewise failed to meet its burden of proof in this case; therefore, \$63,386 in Y2K expenses claimed by the Applicant should be disallowed.

b. Merger Related Expenses

i. Applicant’s Position

In its Initial Brief, the Applicant argues that Mr. Pous has not attacked the level of merger savings achieved in the present case. Any merger savings achieved by TXU Gas Distribution are reflected in the lower operation and maintenance expenses costs in the Applicant’s cost of service. The Applicant argues that the prudently incurred costs to achieve these savings are properly included in this case.

ii. Intervenor’s Position

The City of Dallas recommends that the Commission disallow the Applicant’s request for merger expenses in its revenue requirement. He alleges that these are non-recurring expenses. He notes that rates in this proceeding will be based on a calendar year 1999 test year level of expenses adjusted for known and measurable changes. These merger costs were incurred in 1997. Merger costs of this magnitude did not occur in the test year and are not expected to reoccur each year. Further, he argues that TXU Gas Distribution has not passed through to customers any savings it has realized since the merger. He argues that TXU Gas Distribution has not attempted to offset any of the merger costs with merger savings. Finally, the request represents retroactive ratemaking.³⁵⁰ Although, Mr. Ragland testified that certain information technology expenses will recur, he also conceded that there were specific expenditures for Y2K included in its costs.³⁵¹ Accordingly, the Examiners find that these expenditures should be disallowed.

iii. Examiners’ Analysis and Recommendation

The Examiner recommends that the merger costs be disallowed. The Applicant does not deny that these are not recurring expenses. The Examiners note that the Applicant is correct, however, that all merger savings should be reflected in the current cost of service. Mr. Pous’ implication that a separate merger calculation is required is misplaced. As discussed during the cross-examination by the City of Dallas of Mr. Houle, TXU Gas Distribution’s operations and maintenance expenses have decreased.³⁵² Counsel for the City of Dallas and Mr. Houle estimated that operation and maintenance expenses have been reduced by \$4,572,207.³⁵³ Part of that reduction is due to the merger of Enserch and TXU Corp.³⁵⁴ No further adjustment is necessary.

³⁴⁹ GUD No. 8976 FOF 54.

³⁵⁰ City of Dallas, Ex. 29, p. 94.

³⁵¹ Tr. Vol. 3, p. 13.

³⁵² Tr. Vol. 1, pp. 30, 46, & 55.

³⁵³ Tr. Vol. 1, p 59.

³⁵⁴ Tr. Vol. 1, p. 60.

IX. Allocation of Costs

Cost allocation is the concept by which the costs incurred by a utility in its ownership, operation and maintenance of a particular system are allocated between different classes of customers served by that system.³⁵⁵ As pointed out by Mr. Houle, TXU Gas Distribution has three principal customer classes: (1) residential and (2) commercial customers, who will pay the rates set by the Commission in this proceeding; and (3) industrial/transport and all other customers, who pay rates primarily negotiated pursuant to Texas Utilities Code § 104.003.³⁵⁶

Four broad categories of costs will be allocated in this case: (1) costs of the plant in service; (2) investment additions and investment deductions; (3) operating costs, such as labor and supplies and expenses; and (4) non-operating costs, such as depreciation, taxes, and return. All parties agree that costs must be allocated among the various classes of customers served by TXU Gas Distribution in the Dallas Distribution System. The parties agree that it is necessary to allocate responsibility for costs in a gas distribution system because, although some costs, such as large usage meters, can be readily assigned directly to a specific customer class, most costs associated with a gas distribution system are incurred to serve more than one customer group.³⁵⁷ All parties have proposed a cost allocation methodology which is iterative. Specifically, the allocation of costs builds primarily upon the allocation of the costs of the plant in service.

TXU Gas Distribution argues that the total plant in service cost is \$132,844,332.³⁵⁸ The Applicant has presented a cost allocation study which places 91.87% of those costs on the residential and commercial customers. The remaining 8.13% is to be borne by and other industrial customers. On the other hand, the City of Dallas proposes to allocate 75.90% of the total plant in service costs to the residential and commercial customers. The industrial class would then bear 24.10% of total plant.³⁵⁹ As can be seen on Examiners' Schedule F-2, the Examiners' proposed allocation of total plant in service results in an allocation of 82.42% to residential and commercial customers and 15.57% to industrial customers.

Two principal differences account for the different allocations: (1) classification of the cost of the plant in service, and (2) allocation of demand costs. The key issue with regards to the classification of costs is whether or not a portion of the Dallas South System should be directly assigned to the industrial, electric generation and transportation customers using that system. Once that assignment is accomplished, TXU Gas Distribution argues that none of the demand costs should be allocated to the industrial users. The City of Dallas disagrees and argues that none of the costs on the Dallas South System should be directly assigned. Instead, the majority of costs should be assigned to the demand cost classification and allocated using an average allocation factor. The approach of the City of Dallas leads to a greater proportion of the direct assignment of costs of plant in service to the residential and commercial classes. However, the

³⁵⁵ TXU Gas Distribution, Ex. 1, p. 15.

³⁵⁶ *Id.*

³⁵⁷ *Id.*

³⁵⁸ TXU Cost of Service Schedule, Revised Exhibit 3, p. 11. The Examiners recommend an adjustment to total plant in service due to modification of the factor used to assign general plant. *See* Section V.A.1. Therefore, the total plant in service recommended by the Examiners is \$132,117,797.

³⁵⁹ City of Dallas Ex. 31, Revised Exhibit JP1, p. 2 line 11a.

demands are allocated based upon an average allocation factor, which results in a lower overall allocation of total plant in service costs to the residential and commercial classes.

A. Classification

1. Cost components of plant in service

In order to analyze the classification of costs, the different components of the costs of the plant in service must be identified. The parties are in agreement that plant in service can be divided into six cost components: (1) Meters, (2) House Regulators, (3) Services, (4) Mains, (5) All Other Distribution Plant, and (6) General Plant.

Each customer has at least one meter to measure gas consumption. House regulators are used to reduce the pressure from main lines to the pressure at which gas appliances operate so that customers can use the gas.³⁶⁰ Services investment consists of smaller diameter pipe used to connect small and medium meters to Mains. Piping to connect large meters is considered mains.³⁶¹ Mains consist of large and medium diameter pipe. Most mains are shared among the customer classes.

All Other Distribution Plant includes plant investment incurred specifically to support distribution mains, and includes regulator stations, land, rights of way, and other structures.³⁶² Large district regulators are included in this account. High pressure regulators are responsible for changing pressure along the main and converting the gas to a lower pressure.³⁶³

General Plant consists of the Dallas Distribution System portion of total TXU Gas Distribution general plant investment. General Plant investment is incurred to support the distribution plant as a whole, and includes offices, office equipment, computers, transportation equipment, and communications equipment.³⁶⁴

2. Classification of cost components of plant in service

All parties have divided the six cost components for plant into three classes of costs: direct, customer, demand. A significant portion of the investment costs can be attributed directly to the customer classes. The parties agree that those costs should be directly assigned to the appropriate customer classes instead of being allocated.³⁶⁵ Customer-related costs are those costs of a fixed nature that occur simply because the customers are connected to the system and the system has to have the ability to serve them, regardless of the amount of gas that is actually consumed or the rate of consumption.³⁶⁶ Demand-related costs were considered to be affected by the volume of consumption within each customer class.³⁶⁷

³⁶⁰ Large district regulators are not included in this account. TXU Gas Distribution, Ex. 31, 2.

³⁶¹ TXU Gas Distribution, Ex. 31, p. 2.

³⁶² TXU Gas Distribution, Ex. 31, p. 3.

³⁶³ Tr. Vol. 7, p. 137.

³⁶⁴ TXU Gas Distribution, Ex. 31, 3; TXU Gas Distribution, Exhibit 19, p. 9.

³⁶⁵ TXU Gas Distribution, Ex. 1, p. 17.

³⁶⁶ TXU Gas Distribution, Ex. 1, 17.

³⁶⁷ TXU Gas Distribution, Ex. 1, 19.

3. Cost classification of meters, house regulators, and services

This includes investment costs for meters, house regulators and services.³⁶⁸ The Applicant's witnesses testified that such costs were directly assigned to the appropriate customer classes instead of being allocated.³⁶⁹ All parties agree as to the amounts that are directly assigned for meters, house regulators, and services.³⁷⁰ Examiners' Schedule F-1, lines 1-6, summarize the directly assigned costs agreed by all parties.

4. Cost classification of mains: Direct Costs

Issue: Should a portion of the costs of mains be directly assigned to industrial customers on the Dallas South System?

Examiners' Recommendation: No.

Applicant	Intervenor	Examiners
<u>Mains-Direct</u>	<u>Mains-Direct</u>	<u>Mains-Direct</u>
R&C-\$90,544	R&C-\$90,544	R&C-\$90,544
Ind.-\$1,465,505	Ind.-\$10,344	Ind.-\$10,344

The costs of mains vary with size and capacity. TXU Gas Distribution has argued that, where mains serve specific customers or groups of customers, those mains should also be assigned to a specific customer class as a "direct cost". The Intervenor is in agreement that a certain portion of the costs of the mains can be directly assigned. The parties agree that about ninety thousand dollars of mains can be directly assigned to residential and commercial customers and ten thousand dollars can be directly assigned to industrial customers. This cost is associated with connecting large meters to mains.³⁷¹ These amounts are not in dispute. The Applicant also proposes to directly assign a portion of the costs of the Dallas South System to customers on the Dallas South System.³⁷² In addition, the Applicant argues that a portion of mains should be classified as a customer cost. The City of Dallas contests these allocations.

³⁶⁸ TXU Gas Distribution, Ex. 1, 17.

³⁶⁹ TXU Gas Distribution, Ex. 1, 17.

³⁷⁰ TXU Gas Distribution, Revised Ex. 4.

³⁷¹ TXU Gas Distribution, Revised Ex.4, 1-1J, l. 20 & 30; and, Dallas Exhibit 31, Revised Exhibit JP1, p. 2, l. 4.

³⁷² TXU Gas Distribution, Ex. 1, 17.

a. Applicant's position

TXU Gas Distribution argues that a portion of the cost of the Dallas South System should be directly allocated to the customers that use that system. The estimate of the amount has varied throughout this proceeding. In Mr. Houle's direct testimony, Mr. Houle testified that that amount was \$757,329. Later, in his supplemental direct Mr. Houle testified that that amount was \$765,970.³⁷³ In its initial rate-filing package the Applicant had indicated that the amount was \$1,565,512.³⁷⁴ Finally, in its revised cost of service schedules filed on August 25, 2000, TXU Gas Distribution indicated that that amount was \$1,455,161.³⁷⁵ The Applicant believes that the industrial, commercial, and electric generation customers on the Dallas South System should not be assigned any other costs to operate the mains throughout the Dallas Distribution System. In other words, they should not be assigned the costs associated with operating the segments indicated in red on the map.

TXU Gas Distribution argues that the entire Dallas Distribution System can be divided into three distinct sections. On the map attached to the Proposal for Decision, the three sections are indicated by the red, green, and purple-blue lines. The first section is the intermediate and low-pressure facilities, the red section. These are the mains and service lines that one would normally associate with local gas distribution service in Dallas, Highland Park, University Park and Cockrell Hill. The second section is the Dallas South High Pressure Distribution System, the green section. This is a series of connected high-pressure pipe that essentially forms a "U" around the city. The third section, the blue-purple line, consists of facilities connected to two TXU Electric power plants that are served by TXU Lone Star Pipeline.³⁷⁶

The Dallas South System connects the Dallas East, the Dallas South and the Dallas Central meter stations.³⁷⁷ The Dallas South System transports gas for TXU Lone Star Pipeline to serve, to TXU's Mountain Creek and Parkdale power plants, and to serve American Tile, an industrial customer of LSP and to the city gates of Grand Prairie, Irving, and Duncanville.³⁷⁸

Dr. Anderson testified that, with respect to the Dallas South System, both the volumes and all costs were removed from the total Dallas Distribution System. The portion of those costs associated with mains on the Dallas South System were then assigned to each customer of the system based on design peak-day volumes. For purposes of the analysis, the Dallas Distribution Intermediate System was considered to be a customer served by the Dallas South System. Thus, it is evident from the testimony filed by TXU Gas Distribution that the peak day study included the following six "customers:"

1. Mountain Creek Power Plant
2. Parkdale Power Plant
3. American Tile

³⁷³ TXU Gas Distribution, Ex. 2, 5.

³⁷⁴ Initial rate filing package, page 1-1J, Schedule Classification of Mains Investment, Test Year Ended 12/31/98.

³⁷⁵ TXU Gas Distribution, Revised Ex. 4, 1-1J (Revised Cost of Service)

³⁷⁶ TXU Gas Distribution, Ex. 8, 3.

³⁷⁷ TXU Gas Distribution, Ex. 8, p. 5.

³⁷⁸ TXU Gas Distribution, Ex. 8, p. 5.

4. Grand Prairie City Gates
5. Duncanville City Gate
6. Dallas Distribution Intermediate System

Having calculated the peak-day volumes, TXU Gas Distribution calculated an allocation factor applied to the costs of the Dallas South System. The Applicant concluded that those costs should be \$1,455,161.

b. Intervenor's Position

Mr. Lawton, testifying on behalf of the City of Dallas, stated that the Applicant's attempt to split the integrated system was based on a vague analysis of specific assignments.³⁷⁹ He stated further that the entire system should be treated as one integrated system and that the Applicant's assignment of the specific parts of the system were arbitrary and not appropriate.³⁸⁰ In its Initial Brief, the City argued that the Dallas Distribution System should be viewed as a fully integrated system that cannot be split. The City argued that the Applicant's witnesses had not consistently described the system as two distinct systems. The City further argued that Dr. Anderson had at times described the Dallas Distribution System as one single unit, each portion of which supported the presence of the other.³⁸¹ The City of Dallas further pointed out that Mr. Dixon had characterized the system as being "dynamic" and "pneumatic" and "inseparable."³⁸² Ultimately, the City of Dallas argues that the system is fully integrated and that for purposes of cost assignment and cost allocation should be treated as a fully integrated system.

It must be noted that the testimony of the witnesses for the City of Dallas regarding the classification of costs on the Dallas South System is somewhat confused on the issue of direct cost assignments. On the one hand, Mr. Lawton testified that no portion of the Dallas South System should be assigned directly to the industrial class.³⁸³ And, in its Initial Brief and Reply Brief, the City of Dallas argues that none of the costs of the Dallas South System should be directly assigned because of the integrated nature of the Dallas Distribution System. On the other hand, in schedules prepared on behalf of the City of Dallas, Mr. Pous clearly adopts the amount that Mr. Houle testified to in his initial testimony.³⁸⁴ The schedules prepared by Mr. Pous show that \$765,970 should be directly assigned to the industrial class. Nevertheless, applying the methodology proposed in the testimony and the briefs, it would appear that the costs for mains proposed by the City of Dallas, as applied to the revised figures filed by TXU Gas Distribution, would be divided between directly assigned costs and demand costs.

³⁷⁹ City of Dallas, Ex. 28, p. 43.

³⁸⁰ *Id.*

³⁸¹ City of Dallas, Initial Brief, 63.

³⁸² City of Dallas, Initial Brief, 63.

³⁸³ As will be discussed more fully below, contrary to the methodology proposed by TXU Gas Distribution, Mr. Lawton calculates a peak day allocator using the Dallas South High Pressure system.

³⁸⁴ Dallas, Ex. 31, JP-1, p. 2.

c. Examiners' Analysis and Recommendation

The Examiners recommend that no portion of the Dallas South System be directly assigned to industrial customers. The Applicant defines directly assigned costs as investment costs that can be attributed directly to the customer classes.³⁸⁵ By its own definition, the Applicant's analysis of costs on the Dallas South System is not directly assigned. In order to arrive at that figure, TXU Gas Distribution performs a peak-day study of the Dallas South System *to allocate the costs*. Consequently, costs have not been directly assigned.

While the demarcation may appear clear by marking a line on a map with different colors, in reality it is quite the opposite. TXU Gas Distribution asserts that the physical division between the Dallas South System - the green line on Map 1 - and the rest of the Dallas Distribution System is the result of pressure differences and the location of regulators. Several maps depicting the Dallas South System were entered into evidence. The area depicted as the Dallas South System on the first map filed in the appeal of this case is different from the area depicted as the Dallas South System on the map provided to the Intervenor. A reduced copy of the initial map is attached to this PFD as Map 2. Highlighted in blue is an area of the map showing lines that were originally depicted as part of the Dallas South System.³⁸⁶ On a map later provided to the Intervenor, the Applicant still included a portion of those lines as part of the Dallas South System.³⁸⁷ Finally, that same area, on the map attached to this PFD as Map 1, is removed from the Dallas South System on a map entitled, JLD-1 (Third Edition). If dividing this system for cost allocation purposes has been done since 1985, as described by the Applicant, it is surprising that the depiction of the Dallas South System has not been standardized. Furthermore, Map 1 reveals that there does not appear to be a regulator station between the green and the red line in a portion of that area contained within the blue circle. TXU Gas Distribution claims that regulators and pressure are the clear dividing points between the systems.

In addition, as pointed out by the City of Dallas, and discussed above, TXU Gas Distribution's estimate for these "directly" assigned costs have varied from approximately seven hundred thousand dollars to nearly one and a half million dollars. This wide variation in amounts casts doubt on the cost estimates for the Dallas South System.

Finally, from a regulatory perspective, dividing the system in this manner will always be somewhat arbitrary. To illustrate this problem, consider a simplified pipeline that has existed for some time to provide service to residential and commercial customers at one end of the line. After some time of those residential and commercial customers paying depreciation and operations and maintenance expenses, industrial customers begin to connect to the system at the other end. The following question arises: For cost allocation purposes, at what point in the line is the system divided? Figure 9.1 below describes several possible answers.

³⁸⁵ See TXU Gas Distribution, Ex. 1, 17.

³⁸⁶ City of Dallas, Ex. 7. Attached to the testimony of James Dixon, JLD-1, p. 1. The blue highlight was added to this exhibit by the Examiners.

³⁸⁷ City of Dallas, Ex. 6. The map is entitled TXU gas Distribution, Dallas Distribution System, GUD Docket No. 9145, To City of Dallas RFI Set No. 7, Question No. 9, Revised Exhibit JLD-1.

Figure 9.1



If a regulator is located at point A, the costs allocated to the industrial customer are much less than if the regulator were located at point B or point C. Thus the allocation scheme proposed by the Applicant is dependent upon the arbitrary placement of the described dividing points.

Further, in the case of the Dallas Distribution System, the cost of the mains on the Dallas South System are apparently only \$2,994,374. While it is true that the industrial, commercial, and city gate customers on that line must bear as much as fifty percent of those costs under the proposed allocation, the \$2,994,374 represents a small fraction of the entire DDS investment in mains. Specifically, the industrial, electric generation, and city gate customers served by the Dallas South System are assigned two percent of the entire costs associated with mains. In addition, the methodology proposed by the Applicant suggest that costs can be “directly” assigned every time there are regulators that divide the system into several fractions. Indeed, using this methodology one could argue that residential and commercial customers on one part of the Dallas Distribution System should not be assigned any of the costs to serve residential and commercial customers on another part of the Dallas System if there is a regulator dividing that line.

TXU Gas Distribution points out that costs have been directly assigned on the Dallas Distribution System in this manner since at least 1985. Based on their experience with this cost assignment methodology, it is apparent that the City of Dallas no longer believes that this is an equitable method of assigning costs. The Railroad Commission of Texas has never approved this assignment methodology for the Dallas Distribution System and the Examiners recommend that the Commission reject the Company’s proposal in this case. Finally, the Examiners note that if the Dallas South System is used primarily to transport gas, perhaps TXU Gas Distribution should consider transferring that line to TXU LSP. Nevertheless, TXU Gas Distribution has not elected to do that in this case.

5. Classification of costs of mains: Customer costs

Issue: Should a portion of the costs of mains be directly assigned to the customer class?

Examiners' Recommendation: Yes.

Applicant	Intervenor	Examiners
<u>Mains-Customer</u>	<u>Mains-Customer</u>	<u>Mains-Customer</u>
\$11,742,983	\$0	\$11,742,983

a. Applicant's Position

The Applicant argued that the investment in mains used in common by all customers is partly customer-related and partly demand-related. Mr. Houle testified that the customer-related part is the minimum amount associated simply with having all the customers connected to the system.³⁸⁸ Mr. Houle explained that TXU Gas Distribution is proposing that 16.55% of the mains be classified as customer-related. The balance of the investment, after removing directly assigned costs, would be demand related because the amount of that investment is dependent upon the capacity needs of the system.³⁸⁹

Mr. Houle explained that TXU Gas Distribution adopted the zero intercept method in order to establish the amount of the minimum distribution system. He stated that this method is considered more conservative than other alternatives because it establishes the cost of a theoretical main that has zero capacity.³⁹⁰ For the Dallas Distribution System, the zero intercept cost was determined to be \$3.16 per foot. That cost multiplied by the total footage of mains in the system equals \$11,742,983, which is the amount of customer- related mains.

b. Intervenor's Position

Mr. Pous argues that all pipe for distribution should be treated as demand-related because all customers expect a quantity of gas.³⁹¹ The zero intercept methodology assumes that no gas is delivered. In addition, he argues that the methodology employed by TXU Gas Distribution was erroneous because when he performed the analysis he arrived at a negative coefficient which implies that customers are provided a credit to have pipe installed.³⁹² He draws a parallel for mains to poles and wires for an electric utility and argues that TXU Electric has taken a position inconsistent with the position TXU Gas Distribution is taking here regarding mains.

³⁸⁸ TXU Gas Distribution, Ex. 1, 18.

³⁸⁹ *Id.*

³⁹⁰ *Id.*

³⁹¹ City of Dallas, Ex. 29, p. 101.

³⁹² City of Dallas, Ex. 29, p. 103.

c. Examiners' Recommendation

The Examiners recommend that a portion of the mains be assigned as a customer cost. TXU Gas Distribution has correctly argued that there is a fixed amount of costs necessary to have all customers connected to the gas distribution system. In response to the arguments of the City of Dallas regarding the calculations of the cost of the minimum system, Mr. Dixon testified that the \$3.16 per foot cost for customer-related main investment that results from use of the zero intercept method is very close to the actual current per foot cost to replace a main: \$3.77 per foot without paving, \$3.29 per foot with paving.³⁹³ The Examiners agree that the zero intercept method produces a cost that is close to these figures and representative of the actual costs incurred for investment in mains.

6. Classification of All Other Distribution Plant

The City of Dallas does not dispute the total cost designated as All Other Distribution Plant, \$3,231,774. There is no testimony or briefing on behalf of the City of Dallas that disputes the allocation methodology. The allocation of the costs of the mains has a significant impact on the allocation of All Other Distribution Plant. The costs of All Other Distribution Plant are allocated based on the relative percentages of the allocation of mains. Thus, the parties' various proposed allocations of the cost will influence this subsequent allocation. Table 9.1 summarizes the effect of the Applicant's proposed allocation and compares it to the allocation recommended by the Examiners in this case.

Table 9.1

Allocation of All Other Distribution Plant

Cost Component	R&C	Industrial	Customer	Demand	Total
<i>Applicant's Allocation</i>					
Mains—TXU Gas Dist.	\$90,544	\$1,465,505	\$11,743,983	\$59,281,770	\$72,581,802
Percentage of total	.1%	2%	16.18%	81.17%	
Allocation of "all other"	\$4,032	\$65,253	\$522,912	\$2,639,577	\$3,231,774
<i>Examiners' Allocation</i>					
Mains—Examiners	\$90,544	\$10,344	\$11,743,983	\$60,736,931	\$72,581,802
Percentage of total	.1%	.01%	16.18%	83.68%	
Allocation of "all other"	\$4,032	\$461	\$522,912	\$2,704,370	\$3,231,774

³⁹³ TXU Gas Distribution, Ex. 46, p. 5.

Although the actual allocation methodology is not in dispute, the Examiners note that again, the City of Dallas' position is unclear in this context. The City of Dallas argues that the costs of mains should be assigned between directly-assigned costs and demand-related costs.³⁹⁴ There should be no costs assigned to the customer-related category for mains. However, the City of Dallas does not object to the allocation methodology proposed by TXU Gas Distribution for the assignment of costs of All Other Distribution Plant.³⁹⁵ In other words, costs should be assigned based upon the percentage of mains. Consequently, pursuant to the testimony, there should be no customer-related costs for mains, and therefore no customer-related costs for All Other Distribution Plant. Nevertheless, the schedules prepared by the City of Dallas indicate that customer-related costs should be \$522,912 and that demand-related costs should be \$2,670,749. No explanation is given for how these figures were derived. Table 9.2 shows the allocation of "All Other" based on the percentage of mains.

Table 9.2

Cost Component	R&C	Industrial	Customer	Demand	Total
Mains—City of Dallas ¹	\$90,544	\$1,465,505 ²	\$0	\$71,025,753	\$72,581,802
Percentage of total	.1247474%	2.019110%	0%	97.85614% ³	
Allocation of "all other"					
As presented in City of Dallas Schedules	\$4,032	\$65,253	\$522,912	\$2,670,749	\$3,231,774
Allocation of "all other"					
Based upon unopposed methodology	\$4,032	\$65,253	\$0	\$3,162,489	\$3,231,774

1. The figures have been updated to parallel the costs reflected in TXU Gas Distribution's revised schedules.
2. As noted above, City of Dallas witness Mr. Lawton testified that the Dallas South System should not be segregated; however, Mr. Pous included it in schedules he prepared on behalf of the City of Dallas.
3. Although the actual cost figures have been updated to parallel the revised filing, the percentage of mains assigned to demand costs remains the same.

The Examiners' recommend that the costs of "all other" be assigned as proposed by the Applicant. Although the City of Dallas schedules seem to suggest a different proposed assignment of costs, the rationale is unexplained.

³⁹⁴ City of Dallas, Ex. 29, pp. 101 & 105.

³⁹⁵ City of Dallas, Ex. 29, Ex. JP-1, p. 2.

7. Classification of General Plant

As in the case of the assignment of costs of All Other Distribution Plant, the assignment of costs of general plant is unopposed. TXU Gas Distribution proposes to assign general plant based upon the percentages of total directly allocated plant. The Examiners recommend adoption of the proposed assignment methodology. Although the Company's assignment methodology is adopted, the actual assignment to the various classes is different because of the Examiners' recommendation regarding the assignment of mains. Table 9.3 summarizes the recommendation.

Table 9.3

Cost Component	R&C	Industrial	Customer	Demand	Total
Total Distribution Plant— TXU Gas Dist.	\$46,570,338	\$1,848,113	\$12,266,895	\$61,921,347	\$122,606,693
Percentage of total	37.98652%	1.50735%	10.00508%	50.50405%	
Allocation of general plant	\$3,888,616	\$154,317	\$1,024,284	\$5,170,423	\$10,237,640
Total Distribution Plant— Examiners	\$46,570,338	\$328,160	\$12,266,895	\$63,441,301	\$122,606,693
Percentage of total	37.98352%	.2676523%	10.00508%	51.74370%	
Allocation of "all other"	\$3,888,616	\$27,401	\$1,024,284	\$5,297,339	\$10,237,640

B. Allocation of customer costs

1. Applicant's Position

The Applicant propose that customer-related costs be allocated to the classes on a per-customer basis, without any type of customer weighting, as proposed by the City of Dallas.³⁹⁶ Total customers on the Dallas Distribution System are 236,154. Of that amount, 235,966 customers are residential and commercial customers and 188 are industrial customers. Therefore, under the Applicant's proposal, 99% of customer-related costs would be allocated to the residential and commercial customers and 1% of those costs would be allocated to the industrial customers.

³⁹⁶ TXU Gas Distribution, Ex. 1, 18.

2. Intervenor's Position

Mr. Pous testified that TXU Gas Distribution improperly allocated almost 100% of certain costs and expenses to the residential and commercial classes.³⁹⁷ The Applicant has assigned the same weighting factor to an industrial customer as it has to a residential customer. He suggests that few costs should be allocated on this basis.³⁹⁸ He asserts that it is more costly to serve a large industrial customer compared to a commercial customer. Mr. Pous suggested that in electric utility cases, Mr. Houle, testifying on behalf of TXU Electric, has proposed a customer-weighting factor. He argued that the utility in electric cases has an incentive to make such an argument, whereas in gas utility cases that incentive is absent.³⁹⁹

He argues that some level of customer weighting be recognized so as not to discriminate against residential and commercial customers and to eliminate the inconsistent rate setting process employed by Mr. Houle. He recommends that the industrial cost be assigned a weighting factor thirty-six times greater than the residential class. He bases this relationship on the average historical cost difference between a residential meter and a meter for a large commercial/industrial customer.⁴⁰⁰

3. Examiners' analysis and recommendation

The Examiners recommend that TXU Gas Distribution's proposed allocation for customer costs be adopted. The customer class reflects a level of fixed cost required to serve all customers that cannot be directly assigned. The City of Dallas seems to be arguing that there are no shared fixed costs. Therefore, all costs should be weighted in some manner. This argument ignores the classification of costs. Costs that are demand-related will be weighted based upon an assessment of usage.

C. Allocation of demand costs

1. Applicant's position

Capital investment that is classified as demand-related was allocated by Applicant in proportion to the peak-day responsibility of the customer classes. Dr. Alan Anderson testified on behalf of the Applicant and described the process of developing the various peak day allocators used in this case. Four individuals were involved in the development of the peak day allocators after the City of Dallas rejected the requested rate increase: David Park, Ed Lively, Mike Blackburn, and Dr. Anderson.⁴⁰¹ In determining the peak day volumes, the Applicant calculated the volumes of gas delivered to the customer classes in the Dallas System on the system design

³⁹⁷ City of Dallas, Ex. 29, p. 105.

³⁹⁸ As described by Mr. Pous, "[a]bout the only item for which this type of approach would be appropriate would be for the postage on the envelope to mail the bill to a customer." City of Dallas, Ex. 29, p. 106.

³⁹⁹ Mr. Pous argues that, in electric utility cases, all customers are regulated. In gas utility cases, the Applicant must seek recovery from non-regulated customers for every dollar that is assigned away from residential and commercial customer. *Id.*

⁴⁰⁰ *Id.*

⁴⁰¹ Tr. Vol. 2, p. 33.

peak day.⁴⁰² The calculation of the peak day allocation factor did not include the volumes of gas consumed by the industrial customers on the Dallas South System. Instead, as pointed out above, TXU Gas Distribution attempted to assign those costs using a peak day allocation methodology on the Dallas South System, and assigning that value “directly” to the industrial class. The result of TXU Gas Distribution’s peak day allocation study is a residential and commercial allocation factor of 86.9050%.⁴⁰³ Dr. Anderson points out that based on the design peak day throughput, 91% of the fixed cost of the system is allocated to residential and commercial customers and 9% is allocated to industrial and transportation customer.

2. Intervenor’s Position

The City of Dallas argues that the peak day allocation factor should be 61.81%. The City of Dallas argues that a single winter peak ignores the monthly peak changes on the system.⁴⁰⁴ The single peak allocation factor does not consider the other uses of the system by other customer classes during non-winter months. Mr. Lawton points out that the peak throughput month during the test year was July 1999 and residential and commercial customers accounted for about 10% of July’s throughput.⁴⁰⁵ Mr. Lawton provides the following statistics regarding percentage of system usage by residential and commercial customers:

- 10.35% of the peak month July throughput on the Dallas Distribution System;
- 41.22% of the total annual throughput;
- 69.80% of total annual throughput when the Dallas South System volumes are removed;
- about 80% of the peak winter month throughput; and,
- 83.5% of peak winter month throughput when the Dallas South System volumes are removed.

Mr. Lawton concludes that the Applicant’s assignment of costs exceeds all of these statistics. The City of Dallas proposes a composite allocation factor based on one of three alternative calculation methodologies. All calculations include volumes consumed on the Dallas South System by industrial users.

In his testimony, Mr. Lawton presented three alternative approaches to cost allocation. The first alternative recalculates the peak demand responsibility for residential and commercial customers and combines this theoretical estimate of peak day with the average daily throughput for other customers. A 50% weighting is given to the peak day result and a 50% weighting is given to the average daily throughput for the test year monthly peak of July 1999. Table 9.4 summarizes Mr. Lawton’s analysis of this alternative.

⁴⁰² TXU Gas Distribution, Ex. 1, 19.

⁴⁰³ TXU Gas Distribution, Ex. 4, p. 1-1F, line 12.

⁴⁰⁴ City of Dallas, Ex. 28, 41.

⁴⁰⁵ *Id.*

Table 9.4
City of Dallas Alternative 1

Description	Residential	Commercial	Other	Total
Peak winter day demand	360,894	188,128	48,179	597,201
Percent	60.43%	31.50%	8.07%	100.00%
<i>Peak month throughput</i>	465,230	666,888	9,801,711	10,933,829
Percent	4.25%	6.10%	89.65%	100.00%
Allocator	32.34%	18.80%	48.86%	100.00%
R&C Allocator	51.14%			

In his second alternative, Mr. Lawton combined the same peak day allocator with the average annual system throughput. Table 9.4 summarizes the Intervenor's analysis regarding the second alternative.

Table 9.5
City of Dallas Alternative 2

Description	Residential	Commercial	Other	Total
Peak winter day demand	360,894	188,128	48,179	597,201
Percent	60.43%	31.50%	8.07%	100.00%
<i>Annual throughput</i>	14,629,205	12,874,878	39,225,627	66,729,510
Percent	21.92%	19.29%	58.78%	100.00%
Allocator	41.18%	25.40%	33.43%	100.00%
R&C Allocator	66.57%			

The third alternative developed by the City of Dallas calculates residential and commercial system peak demands and combines these peak demand with the average daily throughput for other customers. The demands for this alternative were calculated based on the total system demands established in GUD No. 8976. Mr. Lawton applied a factor based on cost responsibility for all months to arrive at a Dallas Distribution System residential and commercial demand. The residential and commercial allocator for this alternative was 67.70%.

The City of Dallas proposed an allocation factor that was the average of the three allocation methodologies proposed. Specifically, Mr. Lawton averaged the residential and commercial allocator determined under Alternative 1 - 51.14%, Alternative 2 - 66.57%, and Alternative 3 - 67.70%, thereby arriving at an allocation factor of 61.80%.

3. Examiners' Analysis and Recommendation

The Examiners recommend adoption of the peak day allocation factor calculated as Alternative 2 by the City of Dallas: 66.57%. The Examiners agree that a single winter peak, as proposed by the Applicant, ignores the monthly peak changes on the system and that it is not reasonable to select an allocation factor that exceeds all consumption statistics other than peak day usage. As is apparent by examining Alternative 1, peak month throughput statistics reveal that residential and commercial customers accounted for 4% and 6% of the throughput respectively. Likewise, examination of Alternative 2 reveals residential and commercial customers accounted for 21% and 19% of annual throughput respectively. Allocating costs on the basis of a single winter peak day demand ignores this pattern of consumption. On the other hand, Alternative 1 produces an allocation factor which is unreasonably low, as compared to the usage statistics cited by both Mr. Lawton and Dr. Anderson. Alternative 3 is derived from usage statistics for city-gate deliveries in GUD no. 8976 which may not reflect actual usage within the DDS. Therefore the composite allocation factor proposed by the City of Dallas, which includes Alternatives 1 & 3, should be rejected. Alternative 2 represents the average of a peak winter day demand allocation and an allocation factor based upon annual throughput.

The Examiners recognize that the Natural Gas Rate Review Handbook provides several alternatives for allocating costs. The peak demand methodology is not, however, the exclusive method described. The Handbook notes that other methods can be used to measure and allocate peak demand to different customer classes. One modification noted is calculated using the average of more than one peak demand day during the test year. The Handbook goes on to explain, that "[t]his method can moderate the allocation of costs to a customer class with just one large peak demand." The Handbook also describes a purely volumetric allocation, the 50/50 Seaboard methodology, and the modified 75/25 Seaboard methodology. The Handbook concludes that allocation is a matter of judgment and public policy.

Finally, although TXU Gas Distribution criticizes the Intervenor's approach of averaging daily throughput with peak demand, TXU Gas Distribution has used that methodology in the past and proposed that methodology for allocating costs on the Dallas South System at the City of Dallas. Dr. Anderson testified that the allocation on the "Dallas South High Pressure System in the original filing at the City used a Seaboard method in which there was an averaging of annual throughput with peak day."⁴⁰⁶ Further, in this case, the appeal of the City of Dallas Order, TXU Gas Distribution adjusted the values used for the non-temperature sensitive industrial customers in calculating those peak day volumes. For those customers, the average daily usage over the year was used.⁴⁰⁷

X. Rate Design

The Applicant has proposed three automatic adjustment clauses to its rate design: (1) a Weather Normalization Adjustment Clause ("WNAC"), (2) a "Plant Investment Cost Adjustment Clause ("PICA"), and (3) a Cost of Service Adjustment Clause ("COSA"). The City of Dallas

⁴⁰⁶ Tr. Vol. 2, p. 39-40.

⁴⁰⁷ TXU Gas Distribution, Ex. 48, p. 8.

argues that all three adjustments are unnecessary and should be rejected in this case. The Examiners recommend that the WNAC be adopted. However, the Examiners recommend that both PICA and COSA be rejected.

A. WNAC

1. Applicant's Position

Mr. Florence testified that the cities in the Dallas Distribution System approved the WNAC in 1996, the last times rates were changed in the Dallas Distribution System.⁴⁰⁸ Indeed, he points out that the Dallas City Council specifically voted to approve the WNAC in a vote separate from the approval of the rate ordinance.⁴⁰⁹

He argues that, while rates are set based on the use of the weather-normalized volume data, once rates are set, the margin dollars established will not be realized during the winter months that the actual temperatures are higher or lower than the normal temperatures used to weather-normalize volumes. Therefore, lower than normal temperatures will allow TXU Gas Distribution to earn more margin dollars than it would if the temperatures were normal. Conversely, higher than normal temperatures will cause TXU Gas Distribution to earn fewer margin dollars than it would if the temperatures were normal.⁴¹⁰ Mr. Florence testified that weather has varied over the past several years. As a result, he argues, there will be billing periods within a heating season that reflect lower than normal temperatures and there will be other billing periods that reflect higher than normal temperatures.⁴¹¹ If temperatures are normal, the WNAC will not impact revenues collected.⁴¹²

He notes that the WNAC is designed to allow residential and commercial bills to be adjusted during the heating season of October through May to reflect the impact of higher or lower than normal temperatures. The end result, according to Mr. Florence, is that the volatility of consumers' bills will be reduced during the higher volume winter months and TXU Gas Distribution will have a better opportunity to earn its allowed rate of return.

In response to the arguments by the City of Dallas that the Railroad Commission lacks jurisdiction to set a WNAC, Mr. Florence argues that the Commission is allowed to set rates for municipalities through the appellate process.⁴¹³ A municipality may later adjust rates set through the appellate process if the municipality follows the procedures set forth in the Texas Utilities Code.

2. Intervenor's Position

⁴⁰⁸ TXU Gas Distribution, Ex. 41, 5.

⁴⁰⁹ *Id.*

⁴¹⁰ TXU Gas Distribution, Ex. 26, 30.

⁴¹¹ TXU Gas Distribution Ex. 26, p. 31.

⁴¹² TXU Gas Distribution Ex. 41, p. 4.

⁴¹³ TXU Gas Distribution, Ex. 41, p. 4.

Mr. Lawton argues that rates are based on normal weather assumptions and testified that, in any year, weather will be colder or warmer than normal. However, he was of the opinion that no adjustment to revenues was required under either condition. In those years where weather is colder than normal, the Applicant will earn more revenues and warmer weather results in fewer gas sales and less revenues.⁴¹⁴

Mr. Lawton testified that the WNAC was not necessary and that, in the context of an appeal from municipal rate settings the Railroad Commission, lacked jurisdiction to include a WNAC. Mr. Lawton argues that the Texas Utilities Code does not vest the Railroad Commission with original jurisdiction over the rates in the cities. Under the Applicant's proposal, however, customers' rates would automatically change each year in the future if a WNAC is adopted. In other words it would allow the Applicant to change annually the rates and charges in the City of Dallas. He concludes that this does not appear to be consistent with Utilities Code.⁴¹⁵

3. Examiners' Analysis and Recommendation.

The Examiners agree that a weather normalization adjustment is appropriate. As pointed out by Mr. Florence, variations in weather will cause customers to either under-pay or over-pay for the approved cost of service. There is no mechanism other than a WNAC to insure that the variations from normal temperatures during a heating season do not cause the customers to pay more or less than the allowed cost of service. As noted by the Applicant, the WNAC proposed by TXU Gas Distribution will benefit both the customer and the Applicant. The Examiners note that the WNAC ensures that the Applicant will recover the revenues approved in this case. Finally, the Examiners agree that this Commission has jurisdiction to approve a WNAC and that the Commission has the jurisdiction to set rates through the appellate process.

B. Plant Investment Cost Adjustment (PICA) and Cost of Service Adjustment Clause (COSA).

1. Applicant's Position

Mr. Florence argues that PICA is designed to allow TXU Gas Distribution to adjust its rates to recover the revenue requirement impact (return and federal income taxes) associated with an increase or decrease in net distribution plant subsequent to the time that rates have been set. He explains that the PICA is an annual adjustment based upon the revenue requirement impact of the change in net distribution plant from December 31 of one year to December 31 of the following year. The change in the net distribution plant over the period is first multiplied by the allocation factor used to establish the revenue requirement for residential and commercial service in the city. This determines the residential and commercial class responsibility for the change in net distribution plant. The allocated change in net distribution plant is then multiplied by the allowed rate of return established in this case to determine the return requirement associated with the allocated change in net distribution plant. The resultant federal income tax requirement is then calculated. The revenue requirement derived from this process is then

⁴¹⁴ TXU Gas Distribution, Ex. 26, p. 43.

⁴¹⁵ City of Dallas, Ex. 28, p. 44, citing to Tex. Utilities Code Ann. § 102.002(2).

divided by the total number of residential and commercial bills to determine the required adjustment per residential and commercial bills on an annual basis. Finally, the adjustment will be applied to the customer charge portion of the bill. The Applicant proposes to apply PICA in the May billing month each year and file a statement supporting the calculation of the PICA each year prior to implementing PICA.⁴¹⁶

Similarly, Mr. Florence argues that COSA allows residential and commercial rates to be adjusted annually to reflect changes in “per books” non-gas operating expense per customer. COSA’s operation is similar to PICA. The COSA that TXU Gas Distribution proposes limits the percentage change in operating expense per customer, either upward or downward, to the percentage change in the implicit deflator of gross domestic product. He states that COSA was included because there may be periods in which significant increases or decreases in operating expenses in an individual system occur. COSA will avoid sharp changes in customer’s bills. TXU Gas Distribution proposes to implement COSA in May of each year and a statement detailing the calculation of the COSA will be filed with the city prior to the implementation of COSA.⁴¹⁷ Finally, Mr. Florence notes that COSA has been approved in 241 cities served by TXU Gas Distribution.⁴¹⁸

2. Intervenor’s Position

Mr. Lawton raises a similar argument with regards to PICA and COSA as was raised in the context of a WNAC. He argues that PICA and COSA would allow the Applicant to change rates based on annual changes in net plan. PICA and COSA is unnecessary because the Applicant may file a rate case any time that it becomes necessary.⁴¹⁹

3. Examiners’ Analysis and Recommendation

TUC Section 104.102 states that a gas utility may not increase its rates unless the utility files a statement of intent with the regulatory authority that has original jurisdiction. PICA and COSA are mechanisms that avoid the legislative mandate.⁴²⁰ The Applicant’s arguments in support of PICA highlights this point:

The PICA is merely a more efficient mechanism to determine the level of net invested capital in the Dallas System, and to allow the Company to earn a return on and of that investment. *By avoiding a yearly major rate case both the Company and the ratepayers benefit.*⁴²¹ (emphasis added).

⁴¹⁶ TXU Gas Distribution, Ex. 26 pp. 33-34.

⁴¹⁷ TXU Gas Distribution Ex. 26 pp. 34-36.

⁴¹⁸ *Id.*

⁴¹⁹ City of Dallas, Ex. 28, 44.

⁴²⁰ It is important to recognize the distinction between the WNAC proposal and the proposals for PICA and COSA. The WNAC is a mechanism that allows the utility to recover revenues that were approved by a regulatory authority, despite normal fluctuations in weather. PICA and COSA allow the utility to recover a **greater** revenue than approved.

⁴²¹ TXU Gas Distribution, Reply Brief, p. 82.

Simply stated, PICA is not the mechanism to increase rates that is authorized by statute. There is no mechanism provided by the Texas Utilities Code to avoid a rate case when a utility desires to increase rates. Further, it may not be any more efficient than the statement of intent process. The result may be a full inquiry into rates by a regulatory authority once a year. Finally, while there is a statutory mechanism to suspend rates in the event a statement of intent is filed, there is no discussion by the Applicant addressing the procedures for reviewing the COSA and PICA adjustment before it is applied.

C. Rate Design

1. Applicant's Position.

The Applicant proposed some changes to the design of the base rate. First, the Applicant increased the customer charge and reduced the volumetric component(s) of the rates. Second, the gas cost included in the base rate changed from \$4.02 to \$2.7535 per Mcf. Finally, the revenue-related taxes were removed from the base rate and included as a separate adjustment.

The Applicant has proposed a two-part residential rate structure composed of a customer charge and commodity charges. The proposed residential rate includes an \$8.00 customer charge applicable each month and a commodity charge of \$3.5676 per Mcf applicable to all consumption. Additionally, an off-peak discount of \$0.25 per Mcf for consumption over (8) Mcf per month during the billing months of May through October is proposed.

The proposed commercial rate includes a customer charge and a three step declining block commodity rate. The proposed customer charge is \$14.00 applicable each month. The declining block commodity rate is \$3.7196 per Mcf for the first twenty (20) Mcf consumed each billing period, \$3.4196 per Mcf for the next thirty (30) Mcf consumed in each billing period, and \$3.2696 for each Mcf in excess of fifty (50) Mcf consumed in each billing period.

The proposed customer charges are based on the determination of costs in the Dallas Distribution System. Mr. Florence testified that TXU Gas Distribution is proposing the same basic rate design, including an \$8.00 residential customer charge and a \$14.00 commercial customer charge, in all of its rate cases in order to have a uniform rate design throughout the system.⁴²²

2. Intervenor's Position.

The Intervenor has not actually proposed an alternative rate design. Instead, the Intervenor's testimony is limited to pointing out that the proposed increase to the residential customer charge is 45% (\$5.50 to \$8.00) and the proposed increase to the commercial customer charge is 40% (\$10.00 to \$14.00). Mr. Pous explains that corresponding to the dramatic increase in customer charges are reductions in the volumetric component of the rate.⁴²³ Mr. Pous argues that the Applicant's proposed rate design discriminates against smaller customers within a customer class and that the Applicant's rate design is driven in part by its proposed revenue

⁴²² TXU Gas Distribution, Ex. 26 p. 29.

⁴²³ City of Dallas, Ex. 29, p. 108.

requirement, cost classification and allocation factors. He concludes by recommending that “whatever level of base rate change is ordered by the Commission, that be allocated proportionally to each base rate component of the existing tariff.”⁴²⁴

3. Examiners’ Analysis and Recommendation

The Examiners’ recommend that the essential structure of Applicant’s proposal for customer charges and volumetric rates be adopted. The Examiners’ recommend, however, that the customer charge for residential rates be set at \$7.50 and that the customer charge for commercial rates be set at \$13.00. The Applicant has not established that the dramatic increase in the customer charge is reasonable or necessary. Changes in the volumetric rate for both residential and commercial customers are based on the percentage change in the revenue requirement recommended in this case.

The Intervenor did not challenge the service charges proposed by the Applicant. The Examiners recommend that service charges as proposed by the Applicant be adopted with the following modifications. First, the line extension policy proposed by the Applicant should be rejected because it does not specify the specific fee per foot. Accordingly, the line extension policy on file with the Commission should not be modified. Second, the Applicant proposes that revenue-related taxes not appear as a separate item on customer bills. The Examiners recommend that the Applicant’s proposal be rejected and that a separate line on the bill be added to reflect the tax adjustment.

XI. Rate Case Expenses

The Applicant and the City of Dallas filed and presented a *Joint Stipulation* on rate case expenses on September 25, 2000; no parties cross-examined the witnesses who presented the documentation. Neither the Applicant nor the City of Dallas challenged any aspect of the amount requested by the other party in their respective briefs. No other party asserted any position regarding rate case expenses, conducted any cross-examination of the witnesses, or questioned the expenses of the Applicant or the City of Dallas. The Applicant and the City of Dallas agreed to file schedules of the actual rate case expenses incurred by each of them through August 31, 2000, and those schedules were attached to the *Joint Stipulation* and filed with the Commission on September 25, 2000. These schedules listed the legal and consulting firms involved in the case, the amounts billed by each firm, and the amounts paid by the Applicant for directly incurred expenses. The parties agreed that the schedules filed shall, for all purposes, be viewed as adequate and sufficient evidentiary support for the rate case expenses covered by their stipulation.

The Examiners have reviewed the rate case expenses of the parties in the context of Railroad Commission Rule 7.57:

In any rate proceeding, any utility and/or municipality claiming reimbursement for its rate case expenses . . . shall have the burden to prove the reasonableness of

⁴²⁴ *Id.*

such rate case expenses by a preponderance of the evidence. Each shall detail and itemize all rate case expenses and allocations and shall, in addition, provide evidence showing the reasonableness of the cost of all professional services, including, but not limited to, the amount of work done; the time and labor required to accomplish the work; the nature, extent, and difficulty of the work done; the originality of the work; the charges of others for the work of the same or similar nature; and any other factors taken into account in setting the amount of the compensation. In determining the reasonableness of the rate case expenses, the commission will consider all relevant factors including, but not limited to, those set out previously, and will also consider whether the request for a rate change was warranted, whether there was duplication of services or testimony, whether the work was relevant and reasonably necessary to the proceeding, and whether the complexity and expense of the work was commensurate with both the complexity of the issues in the proceeding and the amount of the increase sought as well as the amount of any increase granted.

After reviewing the proposed rate case expenses, the Examiner makes the following recommendations.

A. The Applicant

The Applicant has requested \$1,288,937.40 in rate case expenses for actual work completed through August 31, 2000. TXU Gas Distribution claims that \$249,000 constitutes the total reasonable and necessary expenses to be incurred by TXU on and after September 1, 2000, for completion of the case before the Commission. The Examiners agree that the Applicant should recover its rate case expenses in the total amount of \$1,537,937.40.

B. The City of Dallas.

The City of Dallas has requested \$531,869.04 in rate case expenses for actual work completed through May 30, 2000. The City of Dallas claims that \$200,000 constitutes the total reasonable and necessary expenses to be incurred by TXU on and after September 1, 2000, for completion of the case before the Commission, thereby bringing its total claimed for attorney's fees to \$731,869.04.

On June 3, 2000 TXU Gas Distribution filed its *Second Motion to Compel*. In that motion, the Applicant sought the "the facts known by the expert that relate to or form the basis of the expert's mental impressions and opinions formed or made in connection with this docket regardless of when and how the factual information was acquired." The language in the request tracked the Texas Rules of Civil Procedure and the City of Dallas should have promptly provided that information. A hearing on the motion was held on July 11, 2000. The Applicant filed an affidavit in support of its attorney's fees that indicated that the Applicant would be billed \$697.50 related to work on its *Second Motion to Compel*. The Examiners recommend that the City of Dallas be required to pay those attorneys fees and that it not be allowed to recovery as rate case expenses a like amount of its own attorney's fees to reflect its costs for work related to that motion. Therefore, the Examiners recommend that \$1,500 be deducted from the City of

Dallas' recovery of rate case expenses for actual work on this motion and that, in addition, another \$3,500 in rate case expenses be deducted from the City's rate case expense recovery as a sanction for discovery abuse, for a total deduction of \$5,000.

On July 17, 2000, TXU Gas Distribution filed its *Motion to Strike and for Sanctions*. As noted by the Applicant in that motion, the Procedural Schedule required the Intervenor to make the work papers of its witnesses available on July 14, 2000. At a prehearing conference held on July 18, 2000, the Intervenor explained that the work papers were made available on Friday, July 14, at 5:00 p.m. However, the Applicant was only allowed to view those documents by appointment starting on Monday, July 17, 2000. At the prehearing conference, the Examiners held that the City of Dallas did not make its work papers available on the date set in the procedural schedule. At the prehearing conference, the Examiners adjusted the procedural schedule to allow the Applicant the opportunity to review the documents in the time originally set out in the procedural schedule. Applicant incurred \$711.00 in attorney's fees related to this motion. In light of the size, complexity and time frame available in a rate case, the Examiners recommend that a total of \$5,000 be deducted from the recovery of rate case expenses by the City of Dallas to cover both parties' attorney's fees (approximately \$1,500) and an additional amount (approximately \$3,500) as sanctions for discovery abuse.

The Examiners have therefore recommended that a total of \$10,000 be deducted from the City of Dallas' recovery of attorneys fees. The City has claimed a total of \$731,869.04; therefore, the Examiners recommend that the City of Dallas be allowed recovery of \$721,869.04.

Issued this 10th day of October, 2000.

Respectfully submitted

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TXU GAS DISTRIBUTION

Dallas Distribution System

Gas Utility Docket Numbers 9145-9148

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TXU GAS DISTRIBUTION
Dallas Distribution System
COST OF SERVICE PROPOSED BY THE APPLICANT, INTERVENOR AND EXAMINERS
ALLOCATED TO R&C CUSTOMERS
Schedule A

Line No.		TXU Proposed Cost of Service	City's Proposed Cost of Service	Examiners' Proposed Cost of Service	Schedule Reference
1	Rate Base	99,579,358	74,354,920	84,978,917	B, Ln.18
2	Rate of Return	9.82%	9.13%	9.75%	G, Ln.4
3	Total Return	9,781,999	6,790,179	8,282,487	
4	Gas Purchases:				
5	for Residential Sales	48,932,498	48,932,498	48,932,498	E, Ln.4
6	for Commercial Sales	40,318,760	40,318,760	40,318,760	E, Ln.4
7	for Company Use	0	0	0	
8	Unaccounted for Gas	0	0	0	
9	Other O & M Expense				
10	O & M Labor	7,864,782	6,660,727	7,376,636	E, Ln.8
11	O & M Supplies and Expenses	18,115,563	15,177,496	16,431,453	E, Ln.9
12	Uncollectible Accounts	508,051	508,051	508,051	E, Ln.10
13	Taxes Other than Income Taxes				
14	Property-Related Taxes	1,282,563	1,059,571	1,144,451	E, Ln.12
15	Payroll-Related Taxes	607,221	547,265	569,532	E, Ln.13
16	Other Operating Expenses				
17	Provision for Depreciation	6,647,877	2,671,960	4,638,353	E, Ln.15
18	Interest on Customer Deposits	327,021	327,021	327,021	E, Ln.16
19	Interest on Customer Advances	0	0	0	E, Ln.17
20	Total Operating Expenses Before Federal Income Taxes	124,604,336	116,203,349	120,246,756	E, Ln.18
21	Federal Income Tax	3,413,523	2,272,106	2,877,887	E, Ln.19
22	SUBTOTAL	137,799,858	125,265,634	131,407,130	
23	Revenue-Related Taxes	8,632,895	7,555,754	8,228,097	E, Ln.24
24	TOTAL COST OF SERVICE	146,432,753	132,821,388	139,635,228	
25	Proposed Increase / (Decrease) (Including Cost of Service related to Service Charges)	8,098,030	(5,513,335)	1,300,505	

TXU GAS DISTRIBUTION

Dallas Distribution System

RATE BASE PROPOSED BY THE APPLICANT, INTERVENOR, AND EXAMINERS

ALLOCATED TO R&C CUSTOMERS

Schedule B

Line No.		TXU Proposed Rate Base	City's Proposed Rate Base	Examiners' Proposed Rate Base **
1	Total Distribution Plant	112,640,199	93,093,066	101,063,369
2	General Plant Allocated	9,405,439	7,776,000	7,839,899
3	City's Recommended Adjustments *	<u>0</u>	<u>(2,650,522)</u>	<u>0</u>
Total Plant in Service Net of Depreciation		122,045,638	98,218,544	108,903,269
4	Construction Work in Progress	0	0	0
5	Retirement Work in Progress	(228,886)	(176,667)	(190,644)
6	Working Capital:			
7	Cash Requirement	(3,521,872)	(7,122,028)	(6,282,550)
8	Materials and Supplies	293,576	225,153	244,527
9	Prepayments	<u>618,525</u>	<u>508,131</u>	<u>554,954</u>
10	Total Investment Additions	(2,838,657)	(6,565,411)	(5,673,713)
11	Customer Deposits	5,474,015	5,474,015	5,474,015
12	Customer Advances	755,818	755,818	755,818
13	Injury & Damage Reserve	343,691	283,934	308,367
14	Investment Tax Credit - Unrestored	1,501,010	1,240,036	1,346,741
15	Accumulated Deferred Income Tax	11,553,089	9,544,410	10,365,697
16	Ind. Mainline Mtr. & Reg. Adjustment	<u>0</u>	<u>0</u>	<u>0</u>
17	Total Investment Deductions	19,627,623	17,298,213	18,250,638
18	TOTAL INVESTED CAPITAL	99,579,358	74,354,920	84,978,917

* The City of Dallas proposed to adjust Rate Base by providing a credit for transportation revenues generated in the Dallas Distribution System.

** See schedule F for the allocation of the Examiners' proposed rate base by customer class.

TXU GAS DISTRIBUTION

Dallas Distribution System

O&M EXPENSES PROPOSED BY THE APPLICANT, INTERVENOR, AND EXAMINERS

ALLOCATED TO R&C CUSTOMERS

Schedule C

Line No.		TXU Proposed O&M Expenses	City's Proposed O&M Expenses	Examiners' Proposed O&M Expenses *
1	Distribution Labor	\$4,641,826	\$3,455,385	\$4,164,752
2	Cust Acctg, Cust. Info & Sales Labor	<u>3,044,568</u>	<u>3,044,568</u>	<u>3,044,568</u>
3	Total Labor Expenses excl. A&G	7,686,394	6,499,953	7,209,321
4	Distribution Supplies & Expenses	6,897,139	5,263,374	6,136,023
5	Cust Acctg, Cust. Info & Sales S&E	4,731,546	4,731,546	4,731,546
6	Adm. & Gen. Labor and S&E	6,665,266	5,343,350	5,731,201
7	Uncollectible Accounts	<u>508,051</u>	<u>508,051</u>	<u>508,051</u>
	Total Other O&M Expenses	18,802,002	15,846,321	17,106,820
8	Total O&M Exp. Excl. Gas Pur & Taxes	26,488,396	22,346,274	24,316,141
9	Property Related Taxes	1,282,563	1,059,571	1,144,451
10	Payroll Related Taxes	<u>607,221</u>	<u>547,265</u>	<u>569,532</u>
11	Total Taxes Other than Revenue and FIT	1,889,784	1,606,836	1,713,983
12	Provision for Depreciation	6,647,877	2,671,960	4,638,353
13	Interest on Cust. Deposits & Advances	327,021	327,021	327,021
14	SUBTOTAL	35,353,078	26,952,091	30,995,498
15	Gas Purchased for Sale	89,251,258	89,251,258	89,251,258
16	Unaccounted for Gas	<u>0</u>	<u>0</u>	<u>0</u>
17	Total Gas Purchased Expense	89,251,258	89,251,258	89,251,258
18	TOTAL EXPENSES (Excl. Rev. Taxes & FIT)	\$124,604,336	\$116,203,349	\$120,246,756

* See Schedule H for the allocation of the Examiners' proposed operating and maintenance expenses by customer class.

TXU GAS DISTRIBUTION
Dallas Distribution System

CURRENT RATE DESIGN AND PROPOSED RATE DESIGN BY THE APPLICANT AND EXAMINERS

Residential Customers

Schedule D-1

Line No.	Description	TXU Current Rates	TXU Proposed Rates	Examiners' ** Proposed Rates
1	Adjusted Bills	2,536,776	2,542,764	2,542,764
2	Customer Charge *	\$5.50	\$8.00	\$7.50
3	Customer Charge Revenue	\$13,952,268	\$20,342,112	\$19,070,730
4	Sales Volumes - Mcf	17,740,855	17,771,018	17,771,018
5	Volume Charge - \$ per Mcf	\$5.1188	\$3.5273	#REF!
6	Volume Charge Revenue	\$90,811,889	\$62,683,712	#REF!
7	Off Peak Volume - Mcf	187,542	211,257	211,257
8	Off Peak Volume - \$ per Mcf	(\$0.2500)	(\$0.2500)	(\$0.2500)
9	Off Peak Vol. Charge Discount Rev.	(\$46,886)	(\$52,814)	(\$52,814)
10	Total Residential Gas Sales Revenue (Excluding Revenue-Related Taxes)		\$82,973,010	#REF!
11	Revenue Related Taxes	Included in Base Rate	\$5,253,913	\$4,978,864
12	Gas Cost Adjustment	(\$23,937,735)		
13	Adjustment	\$168,869		
14	Total Residential Gas Sales Revenue	\$80,948,405	\$88,226,923	#REF!

* The Examiners' proposed customer charge is calculated in proportion to the Applicant's proposed customer charge.

** See Schedule I for more details on the Examiners' proposed rate design.

Notes: The City of Dallas proposed that the base rate ordered by the Commission be allocated proportionally to each base rate component of the existing rate tariff.

In order to compare the present rates with the Company's and Examiners' proposed rates the revenue-related taxes need to be added to the Total Residential Gas Sales Revenue (Ln. 10), since the present rates include these taxes in the base rate. Further, an adjustment to the Total Residential Gas Sales Revenue is necessary in order to adjust the gas purchase expense of \$4.02 per Mcf (present rates) to \$2.7535 (proposed rates). The Company included other adjustment necessary to compare the present rates with the proposed rates.

Lines 10 and 14 correspond to Schedule E lines 23 and 25, respectively. The quantities may not balance due to rounding.

TXU GAS DISTRIBUTION

Dallas Distribution System

CURRENT RATE DESIGN AND PROPOSED RATE DESIGN BY THE APPLICANT AND EXAMINERS

Commercial Customers

Schedule D-2

Line No.	Description	TXU Current Rates	TXU Proposed Rates	Examiners' ** Proposed Rates
15	Adjusted Bills	292,236	294,156	294,156
16	Customer Charge *	<u>\$10.00</u>	<u>\$14.00</u>	<u>\$13.50</u>
		\$2,922,360	\$4,118,184	\$3,971,106
17	Sales Volumes - Mcf	2,836,114	\$2,858,928	2,858,928
18	Volume Charge - \$ per Mcf	<u>\$5.2952</u>	<u>\$3.7023</u>	<u>\$3.5594</u>
19	Total Block 1	\$15,017,791	\$10,584,609	\$10,176,095
20	Sales Volumes - Mcf	2,221,718	2,237,679	2,237,679
21	Volume Charge - \$ per Mcf	<u>\$4.9952</u>	<u>\$3.4023</u>	<u>\$3.2710</u>
22	Total Block 2	\$11,097,926	\$7,613,255	\$7,319,447
23	Sales Volumes - Mcf	9,465,158	9,546,124	9,546,124
24	Volume Charge - \$ per Mcf	<u>\$4.8452</u>	<u>\$3.2523</u>	<u>\$3.1267</u>
25	Total Block 3	\$45,860,584	\$31,046,859	\$29,847,813
26	Total Commercial Gas Sales Revenue (Excluding Revenue-Related Taxes)		\$53,362,907	\$51,314,461
27	Revenue Related Taxes	Included in Base Rate	\$3,379,022	\$3,249,236
28	Gas Cost Adjustment	(\$19,595,869)		
29	Adjustment	\$468,994		
30	Total Commercial Gas Sales Revenue	\$55,771,785	\$56,741,929	\$54,563,696

* The Examiners' proposed commercial rates are calculated in proportion to the Applicant's proposed rate design.

** See Schedule I for more details on the Examiners' proposed rate design.

Notes: The City of Dallas proposed that the base rate ordered by the Commission be allocated proportionally to each base rate component of the existing rate tariff.

In order to compare the present rates with the Company's and Examiners' proposed rates the revenue-related taxes need to be added to the Total Commercial Gas Sales Revenue (Ln. 10), since the present rates include these taxes in the base rate. Further, an adjustment to the Total Commercial Gas Sales Revenue is necessary in order to adjust the gas purchase expense of \$4.02 per Mcf (present rates) to \$2.7535 (proposed rates). The Company included other adjustment necessary to compare the present rates with the proposed rates.

Lines 26 and 30 correspond to Schedule E lines 23 and 25, respectively. The quantities may not balance due to rounding.

TXU GAS DISTRIBUTION

Dallas Distribution System

EXAMINERS' PROPOSED ALLOCATION OF REVENUE REQUIREMENT

Schedule E

Line No.	Description	Total Res & Comm	Total Residential	Total Commercial	Schedule References
1	Rate Base	\$84,978,917	\$56,493,449	\$28,485,469	F, Ln.18
2	Rate of Return	9.75%	9.75%	9.75%	G, Ln.4
3	Total Return	\$8,282,487	\$5,506,145	\$2,776,342	
4	Gas Purchases:				
	Gas Purchases R&C and Industrial	\$89,251,258	\$48,932,498	\$40,318,760	H, Ln.16
5	Company Use	0	0	0	
6	Unaccounted for Gas	0	0	0	
7	Other O & M Expense				
8	O & M Labor	7,376,636	5,701,130	1,675,506	H, (Ln.3 + Ln.6)
9	O & M Supplies and Expenses	16,431,453	12,728,218	3,703,236	H, (Ln.4+Ln.5+Ln.7)
10	Uncollectible Accounts	508,051	455,372	52,679	H, Ln.8
11	Taxes Other than Income Taxes				
12	Property-Related Taxes	1,144,451	786,004	358,448	H, Ln.10
13	Payroll-Related Taxes	569,532	440,170	129,362	H, Ln.11
14	Other Operating Expenses				
15	Provision for Depreciation	4,638,353	3,185,599	1,452,755	H, Ln.13
16	Interest on Customer Deposits	327,021	293,113	33,908	H, Ln.14
17	Interest on Customer Advances	0	0	0	
18	Total Operating Expenses Before Federal Income Taxes	\$120,246,756	\$72,522,104	\$47,724,653	H, Ln.19
19	Federal Income Tax	\$2,877,928	\$1,913,182	\$964,746	H-2, Ln.9
20	SUBTOTAL	\$131,407,172	\$79,941,431	\$51,465,741	
21	Less: Revenue from Service Charges	1,614,534	1,447,125	167,409	
22	Plus: Proposed Changes in Service Rates	150,638	135,019	15,619	
23	TOTAL REVENUE REQUIREMENT (Excluding Revenue-Related Taxes)	129,943,276	\$78,629,325	\$51,313,951	
24	Revenue-Related Taxes	8,228,100	4,978,864	3,249,236	
25	Total Revenue Requirement	138,171,376	\$83,608,189	\$54,563,187	

Note: The Rate Design is based on the Total Revenue Requirement excluding the Revenue-Related Taxes.

TXU GAS DISTRIBUTION
Dallas Distribution System

EXAMINERS' PROPOSED ALLOCATION OF RATE BASE

Schedule F

Line No.	Description	Total System	Total Res & Comm	Total Residential	Total Commercial	Total Industrial	Reference to Allocator Factor
1	Total Distribution Plant	\$122,606,694	\$101,063,369	\$69,409,836	\$31,653,534	\$21,543,325	F - 2
2	General Plant Allocated	\$9,511,103	\$7,839,899	\$5,384,405	\$2,455,494	\$1,671,204	F - 2
3	Total Plant in Service Net of Depreciation	\$132,117,797	\$108,903,269	\$74,794,241	\$34,109,028	\$23,214,528	
4	Construction Work in Progress	0	0	0	0	0	
5	Retirement Work in Progress	(231,283)	(190,644)	(130,933)	(59,711)	(40,639)	F-3, Ln.21
6	Working Capital:						
7	Cash Requirement	(7,034,775)	(6,282,550)	(4,879,237)	(1,403,314)	(752,225)	F-3, Ln.27
8	Materials and Supplies	296,652	244,527	167,940	76,587	52,125	F-3, Ln.21
9	Prepayments	673,252	554,954	381,140	173,814	118,298	F-3, Ln.21
10	Total Investment Additions	(6,296,154)	(5,673,713)	(4,461,090)	(1,212,623)	(622,441)	
11	Customer Deposits	5,474,015	5,474,015	4,906,423	567,592	0	F-3, Ln.2
12	Customer Advances	755,818	755,818	677,448	78,370	0	F-3, Ln.2
13	Injury & Damage Reserve	374,101	308,367	211,785	96,582	65,734	F-3, Ln.21
14	Investment Tax Credit - Unrestored	1,633,821	1,346,741	924,935	421,806	287,080	F-3, Ln.21
15	Accumulated Deferred Income Tax	12,575,316	10,365,697	7,119,111	3,246,586	2,209,619	F-3, Ln.21
16	Ind. Mainline Mtr. & Reg. Adjustment	4,580	0	0	0	4,580	F-3, Ln.21
17	Total Investment Deductions	20,817,651	18,250,638	13,839,702	4,410,936	2,567,013	
18	TOTAL INVESTED CAPITAL	\$105,003,992	\$84,978,917	\$56,493,449	\$28,485,469	\$20,025,075	

TXU GAS DISTRIBUTION
Dallas Distribution System

CLASSIFICATION OF TOTAL INVESTMENT

Schedule F - 1

Line No.	Account Description	A	B	C	D	E	F
		Total System	Direct - Assigned			* Total Customer Classification	* Total Demand Classification
			Total Residential	Total Commercial	Total Industrial		
1	Meters	\$11,330,308	\$6,376,715	\$4,653,672	\$299,921		
2	House Regulators	\$388,480	\$218,637	\$159,560	\$10,283		
3	Services	<u>\$35,074,329</u>	<u>\$25,705,024</u>	<u>\$9,362,154</u>	<u>\$7,151</u>		
4		\$46,793,117	\$32,300,376	\$14,175,386	\$317,355	\$0	\$0
5	Mains	\$72,581,802	\$0	\$90,544	\$10,344	\$11,743,983	\$60,736,931
6	<i>Ratio to Total Mains</i>	1	0	0.001247475	0.000142515	0.161803409	0.836806601
7	All Other Distribution Plant (Columns B,C,D,E, and F are the product of line 6 and column A, line 7)	\$3,231,774	\$0	\$4,032	\$461	\$522,912	\$2,704,370
8	Total Distribution Plant (Sum of lines 4, 5, and 7)	\$122,606,694	\$32,300,376	\$14,269,962	\$328,160	\$12,266,895	\$63,441,301
9	<i>Ratio to Total Dist. Plant</i>	1	0.263447084	0.116388115	0.002676526	0.100050777	0.517437498
10	Total General Plant ** (Columns B,C,D,E, and F are the product of line 9 and column A, line 10)	\$9,511,103	\$2,505,672	\$1,106,979	\$25,457	\$951,593	\$4,921,401
11	TOTAL PLANT IN SERVICE NET OF DEPRECIATION (Sum of lines 8 and 10)	\$132,117,797	\$34,806,048	\$15,376,941	\$353,617	\$13,218,488	\$68,362,702

* See Schedule F-2 for the allocation to the different classes of customers of the costs classified as customer-related and demand-related.

** The Company allocated the Total General Plant investment to the Dallas Distribution System based on the total of customers. Since the Company allocated this investment **within** the Dallas Distribution System based on a ratio to Total Distribution Plant, the Examiners allocated the Total General Plant to the Dallas Distribution System based on the ratio to the Total Distribution Plant. Therefore, the Company allocated \$10,237,640 of General Plant to the DDS and the Examiners allocated \$9,511,103.

TXU GAS DISTRIBUTION
Dallas Distribution System

ALLOCATION OF TOTAL INVESTMENT BY CUSTOMER CLASS

Schedule F - 2

Line No.		Total System	Total Res & Comm	Total Residential	Total Commercial	Total Industrial
1	Meters	\$11,330,308	\$11,030,387	\$6,376,715	\$4,653,672	\$299,921
2	House Regulators	\$388,480	\$378,197	\$218,637	\$159,560	\$10,283
3	Services	<u>\$35,074,329</u>	<u>\$35,067,178</u>	<u>\$25,705,024</u>	<u>\$9,362,154</u>	<u>\$7,151</u>
	Total Plant Allocated based only on Direct-Allocation	\$46,793,117	\$46,475,762	\$32,300,376	\$14,175,386	\$317,355
	Mains:					
4	Direct-Allocation	\$100,888	\$90,544	\$0	\$90,544	\$10,344
5	Customer Related-Allocation	\$11,743,983	\$11,734,647	\$10,517,899	\$1,216,747	\$9,336
6	Demand Related-Allocation	<u>\$60,736,931</u>	<u>\$40,435,461</u>	<u>\$25,009,662</u>	<u>\$15,425,799</u>	<u>\$20,301,470</u>
7	Total Allocated Mains	\$72,581,802	\$52,260,651	\$35,527,561	\$16,733,090	\$20,321,151
8	Other Distribution Plant					
9	Direct-Allocation	\$4,493	\$4,032	\$0	\$4,032	\$461
10	Customer Related-Allocation	\$522,912	\$522,496	\$468,319	\$54,177	\$416
11	Demand Related-Allocation	<u>\$2,704,370</u>	<u>\$1,800,428</u>	<u>\$1,113,579</u>	<u>\$686,848</u>	<u>\$903,942</u>
12	Total Allocated Other Dist. Plant	\$3,231,775	\$2,326,956	\$1,581,899	\$745,057	\$904,819
13	TOTAL DISTRIBUTION PLANT	\$122,606,694	\$101,063,369	\$69,409,836	\$31,653,534	\$21,543,325
14	General Plant					
15	Direct-Allocation	\$3,638,108	\$3,612,652	\$2,505,672	\$1,106,979	\$25,457
16	Customer Related-Allocation	\$951,593	\$950,837	\$852,246	\$98,591	\$757
17	Demand Related-Allocation	<u>\$4,921,401</u>	<u>\$3,276,411</u>	<u>\$2,026,487</u>	<u>\$1,249,924</u>	<u>\$1,644,991</u>
18	TOTAL GENERAL PLANT	\$9,511,103	\$7,839,899	\$5,384,405	\$2,455,494	\$1,671,204
19	TOTAL PLANT IN SERVICE NET OF DEPRECIATION	\$132,117,797	\$108,903,269	\$74,794,241	\$34,109,028	\$23,214,528
20	<i>Ratio to Total Plant in Service</i>	1	82.43%	56.61%	25.82%	17.57%

(1) All the classified customer-related costs are allocated between the Residential, Commercial, and the Industrial Classes based on the corresponding ratio to the total customers served by the company. See Schedule F-3, line 4 for more details on the allocation factor.

(2) All the classified demand-related costs are allocated between the Residential, Commercial, and the Industrial Classes based on the corresponding ratio to the total of the average of Peak Demand Allocator and Throughput Allocator. See Schedule F-3, line 38 for more details on the allocation factor.

Dallas Distribution System

ALLOCATION FACTORS

Schedule F - 3

Line No.		Total System	Total Res & Comm	Total Residential	Total Commercial	Total Industrial
1	Residential and Commercial Cust.		236,410	211,897	24,513	0
2	Ratio to Total		1	0.896311	0.103689	
3	All Customers	236,598	236,410	211,897	24,513	188
4	Ratio to Total	1	0.999205	0.895599	0.103606	0.000795
5	Deposits and Advances Allocated		6,229,833	5,583,871	645,962	0
6	Ratio to Total		1	0.896311	0.103689	
7	Peak Day Delivery from Dist. Plant	597,201	549,022	360,894	188,128	48,179
8	Ratio to Total	1	0.919325	0.604309	0.315016	0.080675
9	Annual Throughput	66,729,510	27,503,883	14,629,205	12,874,678	39,225,627
10	Ratio to Total	1	0.412170	0.219231	0.192938	0.587830
11	Average Peak Day / Throughput	1	0.665748	0.411770	0.253977	0.334252
12	All Meter Investment	11,330,308	11,030,387	6,376,715	4,653,672	299,921
13	Ratio to Total	1	0.973529	0.562802	0.410728	0.026471
14	Number of Meters	284,960	284,684	253,539	31,145	276
15	Ratio to Total	1	0.999031	0.889735	0.109296	0.000969
16	Distribution Plant Investment					
17	Assigned and Allocated	122,606,694	101,063,369	69,409,836	31,653,534	21,543,325
18	Ratio to Total	1	0.824289	0.566118	0.258171	0.175711
19	Total Plant Investment					
20	Assigned and Allocated	132,117,797	108,903,269	\$74,794,241	\$34,109,028	\$23,214,528
21	Ratio to Total	1	0.824289	0.566118	0.258171	0.175711
22	Labor Expense Excluding A&G					
23	Assigned and Allocated	8,100,058	7,209,321	5,571,818	1,637,502	890,737
24	Ratio to Total	1	0.890033	0.687874	0.202159	0.109967
25	Total O&M Exp. Excl. Gas Pur & Taxes					
26	Assigned and Allocated	27,227,570	24,316,141	18,884,720	5,431,421	2,911,429
27	Ratio to Total	1	0.893071	0.693588	0.199482	0.106929

TXU GAS DISTRIBUTION

Dallas Distribution System

EXAMINERS' CASH WORKING CAPITAL

Schedule F - 4

Line No.	Description	A Expenses Based on Examiners' Recommendation	B Average Daily Expense (A / 365)	C Revenue Lag Days	D Expense Lead Days	E Net Lead/Lag Days (C - D)	F Examiners' Recommendation (B * E)	Schedule References (For Lead Days)
	Operation and Maintenance:							
1	Purchased Gas Cost	90,947,450	249,171	30.289	43.307	(13.018)	(3,243,708)	(1)
2	Payroll	8,288,046	22,707	30.289	25.097	5.192	117,895	(3)
3	Pensions and Benefits	2,312,490	6,336	30.289	22.679	7.610	48,219	F - 4-1
4	Other O&M	16,627,034	45,554	30.289	43.651	(13.362)	(608,674)	F - 4-2
	Federal Income Taxes:							
5	Current	2,877,887	7,885	30.289	37.000	(6.711)	(52,914)	(2)
	Taxes Other than FIT:							
6	Payroll Related Taxes	639,900	1,753	30.289	18.401	11.888	20,840	(1)
7	Revenue Related Taxes	9,002,922	24,666	30.289	84.704	(54.415)	(1,342,200)	F - 4-3
8	Ad Valorem	1,388,410	3,804	30.289	234.309	(204.020)	(776,092)	(1)
	Interest on Customer							
9	Advances and Deposits	327,021	896	30.289	1,362.269	(1,331.980)	(1,193,385)	(1)
10	Working Funds and Other						(4,756)	(2)
11	TOTAL CASH WORKING CAPITAL						(7,034,775)	

References: (1) Both parties agreed (2) TXU Exhibit 22, p.1 (3) Dallas Exhibit 31, (Revised Exhibit JP-7)

TXU GAS DISTRIBUTION
Dallas Distribution System

CASH WORKING CAPITAL
(Pensions and Benefits)

Schedule F - 4-1

Line No.	Description	A TY Book Amount	B New Employee 0.082% (A * .082%)	C Existing Employee (A - B)	D New Employee Lead Days	E Existing Employee Lead Days	F New Employee Dollar / Days (B * D)	G Exist. Employee Dollar / Days (C * E)	H Weighted Dollar / Days (F + G)	I Weighted Lead Days (H / A)
1	Overtime Earnings-Non Exempt	(\$706.93)	(\$0.58)	(\$706.35)	45.969 #	14.673 2	(\$26.65)	(\$10,364.28)	(\$10,390.93)	14.699
2	Employee Benefit Loading	9,731,183.22	7,979.57	9,723,203.65	45.969 #	14.673 2	366,812.86	142,668,567.15	143,035,380.02	14.699
3	Group Life Insurance	98,937.03	81.13	98,855.90	75.208	30.208	6,101.50	2,986,239.08	2,992,340.58	30.245
4	Group AD&D Insurance	1,263.60	1.04	1,262.56	75.208	30.208	77.93	38,139.53	38,217.46	30.245
5	Dental Plan	350,686.25	287.56	350,398.69	67.297	22.297	19,352.11	7,812,839.53	7,832,191.64	22.334
6	Medical Plan	602,673.11	494.19	602,178.92	67.297	22.297	33,257.64	13,426,783.34	13,460,040.97	22.334
7	Prescription Plan	411,332.38	337.29	410,995.09	69.604	24.604	23,476.91	10,112,123.13	10,135,600.04	24.641
8	Health Maintenance Organization	840,217.36	688.98	839,528.38	45.000	0.000	31,004.02	0.00	31,004.02	0.037
9	Retirement Plan	1,455,970.85	1,193.90	1,454,776.95	268.500	86.500	320,561.10	125,838,206.51	126,158,767.61	86.649
10	Supplemental Retirement Plan	30,373.69	24.91	30,348.78	268.500	86.500	6,687.38	2,625,169.78	2,631,857.15	86.649
11	Thrift Plan	18,243.01	14.96	18,228.05	18.097	18.097	270.72	329,873.03	330,143.75	18.097
12	Ensave	178,158.30	146.09	178,012.21	8.389	8.389	1,225.55	1,493,344.43	1,494,569.98	8.389
13	Payroll Taxes	8,359.35	6.85	8,352.50	45.969 #	14.673 2	315.10	122,556.16	122,871.27	14.699
14	Other Post Employee Benefits	174,159.07	142.81	174,016.26	45.969 #	14.673 2	6,564.85	2,553,340.58	2,559,905.43	14.699
15	Group Life Insurance-OPEB	281,530.00	230.85	281,299.15	75.208	30.208	17,362.11	8,497,484.58	8,514,846.70	30.245
16	Dental Plan-OPEB	174,313.00	142.94	174,170.06	75.208	30.208	10,749.98	5,261,329.27	5,272,079.25	30.245
17	Medical Plan-OPEB	3,039,786.00	2,492.62	3,037,293.38	67.297	22.297	167,746.15	67,722,530.39	67,890,276.55	22.334
18	Prescription Plan-OPEB	815,645.00	668.83	814,976.17	69.604	24.604	46,553.17	20,051,673.71	20,098,226.88	24.641
19	FAS 112	87,295.15	71.58	87,223.57	45.969 #	14.673 2	3,290.55	1,279,831.41	1,283,121.97	14.699
20	Other Employee Benefits	(147,173.26)	(120.68)	(147,052.58)	45.969 #	14.673 2	(5,547.63)	(2,157,702.48)	(2,163,250.11)	14.699
21	Tuition Reimbursement	5,773.67	4.73	5,768.94	45.969 #	14.673 2	217.64	84,647.59	84,865.23	14.699
22	Miscellaneous General Expense	(1,030.99)	(0.85)	(1,030.14)	45.969 #	14.673 2	(38.86)	(15,115.31)	(15,154.17)	14.699
23										
24	TOTAL	\$18,156,988.86	\$14,888.73	\$18,142,100.13	70.927	22.639	\$1,056,014.12	\$410,721,497.16	\$411,777,511.28	<u>22.679</u>

1 Addition of lines 3 through 12 and lines 15 through 18 of column F, divided by the Addition of lines 3 through 12 and lines 15 through 18 of column B: (684,426.26 / 14,888.73)

2 Addition of lines 3 through 12 and lines 15 through 18 of column G, divided by the Addition of lines 3 through 12 and lines 15 through 18 of column C: (266,195,736.32 / 18,142,100.13)

TXU GAS DISTRIBUTION

Dallas Distribution System

CASH WORKING CAPITAL

(Other O&M)

Schedule F - 4-2

Line No.	Description	Amount	Total (Lead)/Lag Days	Weighted Dollar / Days	Reference
1	PEP Award	899,687.68	(260.132)	(234,037,555.57)	(1)
2	Other O & M	88,992,960.66	(41.609)	(3,702,926,945.85)	Line 8
3	Sales of A/R Fees	<u>1,241,501.00</u>	(33.101)	<u>(41,094,924.60)</u>	(1)
4	Total O & M	91,134,149.34	(43.651)	(3,978,059,426.02)	
5	TUS and TPSRV affiliates	27,745,635.17	(28.792)	(798,852,327.81)	(2)
6	Other affiliates	25,912,090.72	(42.458)	(1,100,175,547.79)	(2)
7	Third party invoices	<u>35,335,234.77</u>	(51.051)	<u>(1,803,899,070.24)</u>	(3)
8	Total Other O & M	88,992,960.66	(41.609)	(3,702,926,945.85)	

References:

- (1) Both parties agreed.
- (2) The City of Dallas did not include this component in the calculation of Other O&M.
- (3) The Examiners' adopted the City's proposed Lead Days.

TXU GAS DISTRIBUTION

Dallas Distribution System

CASH WORKING CAPITAL

(Revenue Related Taxes)

Schedule F - 4-3

Line No.		Description	Amount	(Lead)/Lag	Dollar / Days
1	(See line 9)	Local Gross Receipts Tax	\$25,263,326.30	(85.150)	(\$2,151,164,084.92)
2	(1)	Sate Franchise Tax	138,426.50	(15.127)	(2,093,977.67)
3	(1)	Taxes Other Than Income Tax	<u>37,968.30</u>	(41.586)	<u>(1,578,949.72)</u>
4		Total Revenue-Related Taxes	\$25,439,721.10	(84.704)	(\$2,154,837,012.31)

Line No.		Payment	(Lead)/Lag Days	Check Float	Total (Lead)/Lag	Weighted Dollar / Days
5	Dallas Direct	\$5,649,595.11	(90.989)	0.000	(90.989)	(\$514,051,009.46)
6	Dallas Third Party	931,260.86	(91.350)	0.000	(91.350)	(85,070,679.56)
7	University Park Direct	192,384.30	146.809	(13.744)	133.065	25,599,616.88
8	University Park Third Party	<u>20,479.11</u>	(228.500)	(13.744)	(242.244)	<u>(4,960,941.52)</u>
9	Local Gross Receipt Taxes	\$6,793,719.38			(85.150)	(\$578,483,013.67)

References:

(1) Both parties agreed.

Notes:

The Examiners' adopted the City's proposed Lead Days for the Local Gross Receipt Taxes, with the exception of a correction to the Lead Days assigned to University Park Third Party.

TXU GAS DISTRIBUTION

Dallas Distribution System

Examiners' Rate of Return

ALLOCATED TO R&C CUSTOMERS

Schedule G

Line No.	Description	Rate Base	Capital Structure	Rate Base by Source of Capital	Cost / Rate on Invested Capital	Weighted Cost/Rate on Invested Capital
1	Debt	\$84,978,917	47.10%	40,025,070	7.34%	2,937,840
2	Preferred Stock	\$84,978,917	1.70%	1,444,642	5.54%	80,033
3	Common Equity	\$84,978,917	<u>51.20%</u>	<u>43,509,206</u>	<u>12.10%</u>	<u>5,264,614</u>
4			100.00%	84,978,917	9.75%	8,282,487

TXU GAS DISTRIBUTION
Dallas Distribution System

EXAMINERS' PROPOSED ALLOCATION OF OPERATING AND MAINTENANCE EXPENSES

Schedule H

Line No.		Total System	Total Res & Comm	Total Residential	Total Commercial	Total Industrial	Reference to Allocator Factor
1	Distribution Labor	5,052,538	4,164,752	2,860,332	1,304,420	887,786	Sch. F-3, Ln.16
2	Cust Acctg, Cust. Info & Sales Labor	<u>3,047,520</u>	<u>3,044,568</u>	<u>2,711,486</u>	<u>333,082</u>	<u>2,952</u>	Sch. F-3, Ln.14
3	Total Labor Expenses excl. A&G	8,100,058	7,209,321	5,571,818	1,637,502	890,737	
4	Distribution Supplies & Expenses	7,444,017	6,136,023	4,214,191	1,921,832	1,307,994	Sch. F-3, Ln.16
5	Cust Acctg, Cust. Info & Sales S&E	4,736,133	4,731,546	4,213,905	517,641	4,587	Sch. F-3, Ln.14
6	Adm. & Gen. Labor	187,988	167,316	129,312	38,004	20,672	Sch. F-3, Ln.22
7	Adm. & Gen. S&E	6,251,323	5,563,885	4,300,122	1,263,763	687,438	Sch. F-3, Ln.22
8	Uncollectible Accounts	<u>508,051</u>	<u>508,051</u>	<u>455,372</u>	<u>52,679</u>	<u>0</u>	Sch. F-3, Ln.3
9	Total O&M Exp. Excl. Gas Pur & Taxes	19,127,512	17,106,820	13,312,902	3,793,918	2,020,692	
	Total O&M Exp. Excl. Gas Pur. & Taxes	27,227,570	24,316,141	18,884,720	5,431,421	2,911,429	
10	Property Related Taxes	1,388,410	1,144,451	786,004	358,448	243,959	Sch. F-3, Ln.19
11	Payroll Related Taxes	<u>639,900</u>	<u>569,532</u>	<u>440,170</u>	<u>129,362</u>	<u>70,368</u>	Sch. F-3, Ln.22
12	Taxes Other than Revenue and FIT	2,028,310	1,713,983	1,226,174	487,809	314,326	
13	Provision for Depreciation	5,627,095	4,638,353	3,185,599	1,452,755	988,742	Sch. F-3, Ln.19
14	Interest on Cust. Deposits & Advances	327,021	327,021	293,113	33,908	0	Sch. F-3, Ln.5
15	SUBTOTAL	35,209,996	30,995,498	23,589,606	7,405,893	4,214,497	
16	Gas Purchased for Sale	90,947,450	89,251,258	48,932,498	40,318,760	1,696,192	Direct Assigned
17	Unaccounted for Gas	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	
18	Total Gas Purchased Expense	90,947,450	89,251,258	48,932,498	40,318,760	1,696,192	
19	TOTAL EXPENSES (Excl. Rev. Taxes & FIT)	126,157,446	120,246,756	72,522,104	47,724,653	5,910,689	

TXU GAS DISTRIBUTION

Dallas Distribution System

EXAMINERS' PROPOSED DEPRECIATION EXPENSE

Total System

Schedule H - 1

Line No.	Description	Investment Less Land	Depreciation Rate	Depreciation Expense
1	Distribution Plant	\$195,068,743	2.29%	\$4,458,110
2	Depreciation Amount for Completed Not Classified			<u>65,298</u>
3	Total Distribution Plant			\$4,523,408
4	Structures & Improvements	\$14,244,720	1.70%	\$242,183.57
5	Furniture and Equipment	6,761,718	1.67%	\$112,995.71
6	Radio Communication EQ	3,177,041	0.00%	\$0.00
7	Miscellaneous Equipment	14,562,937	6.25%	\$909,489.95
8	Non-Mainframe Computer EQ	11,239,210	25.71%	\$2,889,330.00
9	Computer Software	21,752,519	10.00%	\$2,175,251.90
10	Subtotal			\$6,329,251.14
11	Depreciation Amount for Completed Not Classified			<u>603,890</u>
12	Total General Plant			\$6,933,141
13	Allocation Factor (Based on Total Distribution Plant)			* 0.15919
14	Total General Plant Allocated to the Dallas Distribution System			\$1,103,687
15	TOTAL DEPRECIATION EXPENSE			\$5,627,095

* Total Dallas Distribution Plant	\$195,224,131
TXU Gas Distribution Gross Distribution Plant	\$1,226,345,903
Total Ratio	0.15919

TXU GAS DISTRIBUTION
Dallas Distribution System

FUNCTIONAL DEPRECIATION RATE
Average Life Group

Schedule H - 1-1

Line No.	NARUC Acct. No.	Description	A Account Balance	B Allocated Reserve	C Balance (A - B)	D Net Salvage %	E Salvage Adjustment (A * D)	F Adjusted Balance (C - E)	G Remaining Life	H Annual Depreciation (F / G)
Distribution Plant										
1	374	Land Rights	\$1,611,652	\$666,747	\$944,905	0.00%	\$0	\$944,905	41.46	22,791
2	375	Structures and Improvements	3,490,514	2,987,985	502,529	-30.00%	(1,047,154)	\$1,549,683	16.93	91,535
3	376.3	Mains-Plastic	580,532,460	133,141,368	447,391,092	-30.00%	(174,159,738)	\$621,550,830	59.90	10,376,475
4	376.4	Mains-Valves	20,641,883	10,100,464	10,541,419	-30.00%	(6,192,565)	\$16,733,984	30.17	554,656
5	376.5	Mains-Steel Mill Wrapped and Bar	164,871,722	51,269,835	113,601,887	-30.00%	(49,461,517)	\$163,063,404	55.78	2,923,331
6	378	M&R Station Equipment-General	11,666,264	5,646,504	6,019,760	-30.00%	(3,499,879)	\$9,519,639	23.59	403,546
7	379	M&R Station Equipment-City Gate	3,238,885	1,691,469	1,547,416	-30.00%	(971,666)	\$2,519,082	29.17	86,359
8	380	Services	307,276,805	96,884,143	210,392,662	-30.00%	(92,183,042)	\$302,575,704	30.27	9,995,894
9	381	Meters	110,978,869	48,789,139	62,189,730	-30.00%	(33,293,661)	\$95,483,391	33.07	2,887,311
10	383	Meter Installations	21,641,668	6,992,912	14,648,756	-30.00%	(6,492,500)	\$21,141,256	31.29	675,655
11	387	Other Equipment	64,811	3,021	61,790	-30.00%	(19,443)	\$81,233	43.59	1,864
			<u>\$1,226,015,533</u>	<u>\$358,173,587</u>	<u>\$867,841,946</u>		<u>(367,321,164)</u>	<u>\$1,235,163,110</u>		<u>\$28,019,416</u>
General Plant										
12	390	Structures and Improvements	\$14,244,720	\$4,428,371	\$9,816,349	15.00%	\$2,136,708	\$7,679,641	31.71	\$242,184
13	391	Office Furniture and Equipment	6,761,718	5,820,235	941,483	5.00%	338,086	603,397	5.34	112,996
14	392	Transportation Equipment	19,773,808							
15	396	Power Operated Equipment	7,089,701							
16	397	Communication Equipment	3,177,041	3,077,465	99,576	0.00%	0	99,576	12.57	7,922
17	398	Computer Equipment	11,239,210	8,349,880	2,889,330	0.00%	0	2,889,330	0.76	2,889,330
18	398	Miscellaneous Equipment	<u>14,562,937</u>	<u>8,587,588</u>	<u>5,975,349</u>	0.00%	<u>0</u>	<u>5,975,349</u>	6.57	<u>909,490</u>
			<u>\$76,849,135</u>	<u>\$30,263,539</u>	<u>\$19,722,087</u>		<u>\$2,474,794</u>	<u>\$17,247,293</u>		<u>\$4,161,921</u>

See Schedule H-1-2 for details in the calculation of the Remaining Life.

Dallas Distribution System

REMAINING LIFE Average Life Group

Schedule H - 1-2

Line No.	NARUC Acct. No.	Description	A Account Balance	B Average Life and Curve Type	C Theoretical Accrued Depreciation	D Balance (A - C)	E Annual Rate %	F Annual Depreciation (A * E)	G Remaining Life (D / F)
Distribution Plant									
1	374	Land Rights	\$1,611,652	65 R5	\$583,928	\$1,027,724	1.538%	\$24,787	41.46
2	375	Structures ar	3,490,514	40 R2.5	2,012,950	1,477,564	2.500%	87,263	16.93
3	376.3	Mains-Plastic	580,532,460	70 R2	83,651,757	496,880,703	1.429%	8,295,809	59.90
4	376.4	Mains-Valve:	20,641,883	45 R4	6,804,495	13,837,388	2.222%	458,663	30.17
5	376.5	Mains-Steel I	164,871,722	70 R1.5	33,460,157	131,411,565	1.429%	2,356,017	55.78
6	378	M&R Station	11,666,264	35 R1.5	3,803,946	7,862,318	2.857%	333,305	23.59
7	379	M&R Station	3,238,885	45 R2.5	1,139,512	2,099,373	2.222%	71,968	29.17
8	380	Services	307,276,805	38 L1.5	62,477,337	244,799,468	2.632%	8,087,526	30.27
9	381	Meters	110,978,869	47 R3	32,868,339	78,110,530	2.128%	2,361,630	33.07
10	383	Meter Install	21,641,668	40 R2.5	4,710,995	16,930,673	2.500%	541,042	31.29
11	387	Other Equipn	64,811	45 R2.5	2,035	62,776	2.222%	1,440	43.59
			\$1,226,015,533		\$231,515,451	\$994,500,082		\$22,619,449	
General Plant									
12	390	Structures ar	\$14,244,720	49 R2	\$5,026,579	\$9,218,141	2.041%	\$290,735	31.71
13	391	Office Furnitu	6,761,718	20 R4	4,956,644	1,805,074	5.000%	338,086	5.34
14	392	Transportatic	19,773,808	9 L3	11,117,438	8,656,370	11.111%	2,197,068	3.94
15	396	Power Operæ	7,089,701	13 L3	3,947,451	3,142,250	7.692%	545,340	5.76
16	397	Communicati	3,177,041	25 R3	1,579,245	1,597,796	4.000%	127,082	12.57
17	398	Computer Eq	11,239,210	5 R5	9,531,368	1,707,842	20.000%	2,247,842	0.76
18	398	Miscellaneous	14,562,937	15 R2	8,182,120	6,380,817	6.667%	970,911	6.57
			\$76,849,135		\$44,340,845	\$32,508,290		\$6,717,063	

TXU GAS DISTRIBUTION

Dallas Distribution System

EXAMINERS' PROPOSED FEDERAL INCOME TAX AND OTHER TAXES

Schedule H - 2

Line No.				Reference	
		Total Res.&Comm.	Residential Cust.	Commercial Cust.	
1	Rate Base	\$84,978,917	\$56,493,449	\$28,485,469	F, Ln.18
2	Rate of Return	<u>9.75%</u>	<u>9.75%</u>	<u>9.75%</u>	G, Ln.4
3	Required Return	\$8,282,487	\$5,506,145	\$2,776,342	
4	Interest on Long Term Debt	<u>(\$2,937,840)</u>	<u>(\$1,953,093)</u>	<u>(\$984,670)</u>	
5	Net After Tax Income	\$5,344,647	\$3,553,052	\$1,791,672	
6	Gross-Up Factor [1/(1-0.35)]	<u>1.5385</u>	<u>1.5385</u>	<u>1.5385</u>	
7	Net Taxable Income	\$8,222,534	\$5,466,234	\$2,756,418	
8	Federal Income Tax Rate	35.00%	35.00%	35.00%	
9	Federal Income Tax	\$2,877,887	\$1,913,182	\$964,746	
		Total System			
10	Total Plant in Service	\$132,117,797			F, Ln.3
11	Property Tax Rate	<u>1.05%</u>			
12	Property-Related Taxes	1,388,410			
		Total System			
13	Payroll Related Taxes per Books	659,726			
14	Adjusted Labor	8,288,046			
	Per Books Labor	<u>8,549,295</u>			
	Labor Adjustment	(261,249)			
14	Payroll Tax Rate	<u>7.59%</u>			
15	Payroll Tax on Labor Adjustment	(19,826)			
	Payroll-Related Taxes	639,900			
	(Line 13, plus Line 15)				

* See Schedule H for the allocation of Property-Related Taxes and Payroll Related Taxes by customer class.

TXU GAS DISTRIBUTION
Dallas Distribution System

Rate Design

Schedule I

Line
No.

Residential Rate Design

1	Residential Revenue Requirement (Excluding Revenue-Related Taxes)	\$78,629,325
2	Less: Revenue from Customer Charge (2,542,764 * \$7.50) (Adjusted Bills multiplied by the Customer Charge)	<u>19,070,730</u>
3	Revenue Required from Commodity Rate	\$59,558,595
4	Plus: Off Peak Discount (211,257 * \$0.25) (Off Peak Volume-Mcf multiplied by the Off Peak Discount)	<u>52,814</u>
5	Total	\$59,611,409
6	Divided by Total Mcf	<u>17,771,018</u>
7	Examiners' Proposed Commodity Rate	\$3.3544

Commercial Rate Design

8	Commercial Revenue Requirement (Excluding Revenue-Related Taxes)	\$51,313,951
9	Less: Revenue From Customer Charge (294,156 * 13.50) (Adjusted Bills multiplied by the Customer Charge)	<u>3,971,106</u>
10	Revenue Required from Commodity Rate	\$47,342,845
11	Percent of Rev for Block 1 based on TXU Rate Design	<u>21.493869%</u>
12	Revenue for Block 1 based on Examiners' Rev. Requirement (Ln.10 * Ln.11)	10,175,809
13	Total Sales Volumes (Mcf) for Block 1 based on Exhibit 4	<u>2,858,928</u>
14	Examiners' Proposed Rate for Block 1 (Ln. 12 / Ln. 13)	3.5594
15	Percent of Rev for Block 2 based on TXU Rate Design	<u>15.460041%</u>
16	Revenue for Block 2 based on Examiners' Rev. Requirement (Ln. 10 * Ln.15)	7,319,223
17	Total Sales Volumes (Mcf) for Block 2 based on Exhibit 4	<u>2,237,679</u>
18	Examiners' Proposed Rate for Block 2 (Ln. 16 / Ln. 17)	3.2710
19	Percent of Rev for Block 3 based on TXU Rate Design	<u>63.046090%</u>
20	Revenue for Block 3 based on Examiners' Rev. Requirement	29,847,813
21	Total Sales Volumes (Mcf) for Block 3 based on Exhibit 4	<u>9,546,124</u>
22	Examiners' Proposed Rate for Block 3	3.1267

RAILROAD COMMISSION OF TEXAS

**APPEAL OF TXU GAS DISTRIBUTION §
FROM THE ACTION OF THE CITY OF §
DALLAS, CITY OF UNIVERSITY PARK, §
AND THE TOWN OF HIGHLAND PARK, §
TEXAS AND STATEMENT OF INTENT §
FILED BY TXU GAS DISTRIBUTION §
INCREASE RATES CHARGED IN THE §
ENVIRONS OF THE CITY OF DALLAS, §
CITY OF UNIVERSITY PARK, CITY OF §
COCKRELL HILL, AND THE TOWN OF §
HIGHLAND PARK**

G.U.D. NO. 9145-9147;9148**PROPOSED FINAL ORDER**

1. TXU Gas Distribution owns and operates a distribution system serving approximately 237,415 customers in the City of Dallas, University Hill, Cockrell Hill, and the Town of Highland Park.
2. On August 27, 1999, TXU Gas Distribution filed a Statement of Intent with the City of Dallas, University Park, Cockrell Hill, and the Town of Highland Park.
3. On February 23, 2000, the City of Dallas denied the proposed rate increase.
4. TXU Gas Distribution filed a Motion for Rehearing with the Dallas City Council on February 28, 2000.
5. On March 8, 2000, the Dallas City Council issued a final order denying the requested rate change.
6. On March 21, 2000, the City of University Park denied the requested rate change.
7. On March 28, 2000, Cockrell Hill approved a negotiated rate based on the Statement of Intent.
8. TXU Gas Distribution filed an appeal to the Railroad Commission of Texas on April 7, 2000, pursuant to Texas Utilities code §§ 103.051 & 103.054.
9. The City of Dallas Intervened on April 14, 2000.
10. TXU Gas Distribution updated its rate-filing package for known and measurable changes through December 31, 1999, on May 24, 2000.

11. The City of Dallas filed its direct testimony on July 12, 2000, the Applicant filed rebuttal testimony on July 31, 2000, and the hearing was held beginning August 1, 2000, and ending August 10, 2000.

Rate Base

12. A portion of TXU Gas Distribution's cost for General Plant, Retirement Work in Progress, Materials and Supplies, and Prepayments is assigned to the Dallas Distribution System.
13. The Applicant requested assignment of General Plant to the Dallas Distribution System on the basis of total number of customers.
14. Total customers for TXU Gas Distribution is 1,384,515. Total customers for the Dallas Distribution System is 237,415.
15. The ratio of total TXU Gas Distribution customers to Dallas Distribution System customers is 0.171479.
16. The City of Dallas requested assignment of General Plant to the Dallas Distribution System on the basis of gross distribution plant.
17. The total gross cost of the distribution system plant of TXU Gas Distribution is \$1,226,345,903. The total gross cost of the distribution system plant of the Dallas Distribution System is \$195,224,132.
18. The ratio of total TXU Gas Distribution distribution plant to Dallas Distribution System distribution plant is 0.15919.
19. TXU Gas Distribution requested assignment of costs for General Plant, RWIP, Materials and Supplies, and Prepayments on the basis of the ratio of total customers.
20. The City of Dallas requested assignment of costs for General Plant, RWIP, Materials and Supplies, and Prepayments on the basis of the ratio of total distribution plant.
21. General plant, RWIP, Materials and Supplies, and Prepayments support and follow distribution plant investment.
22. General plant is allocated within the Dallas Distribution System on the basis of distribution plant investment.
23. It is reasonable and consistent to allocate TXU Gas Distribution costs for General Plant, RWIP, Material and Supplies, and Prepayments on the basis of total distribution plant.
24. Total Net General Plant for TXU Gas Distribution is \$59,746,895.

25. Total Net General Plant for the Dallas Distribution System is \$9,511,103.
26. RWIP expenses for TXU Gas Distribution are negative \$1,452,876.
27. RWIP expenses for the Dallas Distribution System are negative \$231,283.
28. Material and Supplies expenses for TXU Gas Distribution are \$1,863,506.
29. Material and Supplies expenses for Dallas Distribution System are \$296,652.
30. Prepayment expenses for TXU Gas Distribution are \$4,205,613.
31. Prepayment expenses for the Dallas Distribution System are \$673,252.
32. The Applicant initially testified that a cash working capital of \$1,793,456 was required.
33. In rebuttal testimony, the Applicant modified its request for a cash working capital requirement to a negative \$3,704,404.
34. The City of Dallas argued that the cash working capital requirement should be a negative \$8,295,117.
35. A lead-lag study is the proper tool to measure TXU Gas Distribution's cash working capital requirement for the Dallas Distribution System.
36. The Applicant cash working capital request is based on a lead-lag study.
37. A revenue lag of 1.488 days for receipt of funds is reasonable and a revenue lag of 30.289 days is reasonable.
38. The Applicant requested a payroll lead days of 13.177.
39. The Applicant did not include a separate analysis for vacation leave working capital requirements.
40. Different service periods are associated with vacation pay.
41. It is not reasonable to calculate a payroll lead day without performing an analysis of the different service periods associated with vacation pay.
42. A payroll lead day of 25.097 takes into consideration the vacation leave working capital requirements.
43. The Applicant requested pension lead days of 22.181.

44. The Applicant calculated the pre-qualification period for new employees only.
45. The City of Dallas calculated a pre-qualification period for all employees.
46. It is not reasonable to calculate the pre-qualification period for all employees.
47. The Applicant did not measure the lead days between when an employee makes a claim for a benefit and the time that the Applicant must honor that claim.
48. The appropriate lead days associated with the calculation of benefits is 22.679.
49. The Applicant requested 24.561 lead days for Other Operations and Maintenance.
50. It is reasonable to use the invoice date as the starting point in calculating the lead period of Operations and Maintenance expenses.
51. It is reasonable to use the due date on the invoice to calculate the endpoint for determining the lead period of Operations and Maintenance expenses.
52. The Applicant proposed using a composite lead day for revenue related taxes.
53. 43.651 lead days are reasonable for Operations and Maintenance expenses.
54. It is reasonable to use actual tax payments in calculating the lead days associated with local gross receipt taxes whenever available.
55. 84.794 lead days are reasonable for revenue related taxes.
56. The Applicant proposed 37 lead days for Federal Income Taxes.
57. The Intervenor proposed adoption of an expense lead day for Federal Income Taxes calculated in another docket.
58. Adoption of an expense lead day calculation developed in another case is not reasonable.
59. The Applicant's proposed expense lead day of 37 days is reasonable.
60. TXU Gas Distribution's lead-lag study included revenues associated with return, depreciation, and deferred federal income taxes.
61. Return, depreciation, and deferred federal income taxes are non-cash items that should not be included in a lead lag study.
62. TXU Gas Distribution requested an allowance of \$276,031 for average daily bank balances.

63. The lead-lag study shows that TXU Gas Distribution's shareholders may not be supplying the working cash that the Applicant needs to operate the Dallas Distribution System; ratepayers should not be required to compensate shareholders for interest on funds they did not provide.
64. TXU Gas Distribution has requested a negative \$4,756 for working funds and other.
65. The Intervenor requested that sales taxes be removed from the calculation of working funds and other.
66. The Applicant has demonstrated that sales taxes were removed from the calculation of working funds and other. A cash working capital requirement of a negative \$4,756 is reasonable for working funds and other.
67. Based on findings of fact 35 to 67 a cash working capital requirement of a negative 7,034,775 is reasonable.
68. TXU Gas Distribution has not requested any funds for construction work in progress.
69. TXU Gas Distribution has not requested any funds for retired work in progress.

Rate of Return

70. TXU Gas Distribution's capital structure should be based on the average capital structure of a proxy group of local distribution companies (LDCs).
71. Based on an analysis of the proxy group a capital structure of 47.1 percent long term debt, 1.7 percent preferred stock, and 51.2 percent common equity is reasonable.
72. A cost of debt for TXU Gas Distribution of 7.24% is reasonable.
73. A cost of preferred stock for TXU Gas Distribution of 5.54% is reasonable.
74. A cost of equity of 12.1% based on a discounted cash flow (DCF) analysis is reasonable.
75. A cost of equity of 12.1% is within the range of reasonableness predicted by the risk premium analysis.
76. An overall rate of return of 9.75% is reasonable.

Revenues

77. Since 1994, TXU Gas Distribution sold forty-two separate assets and reported a realized net profit of \$3,219,341 on the sale of land related to a portion of these assets.
78. Ratepayers have not paid any depreciation expense related to the land that was sold.

79. The City of Dallas did not establish that ratepayers undertook any risk associated with the ownership or sale of land.
80. All the property referenced in finding of fact 77 above was sold outside of the test year.
81. Based on findings of fact 77-80 it is reasonable that the ratepayers not receive a credit related to the sale of assets.
82. Weather has an impact on the sale of gas which in turn affects revenues as well as income.
83. In determining a utility's revenue deficiency or surplus, it is necessary to use weather normalized sales.
84. TXU Gas Distribution has correctly calculated the weather-normalized adjustment.
85. The evidence in the record does not suggest that a consumption pattern normalization adjustment is necessary.
86. All data indicates that Mcf/customer usage has consistently declined since 1994. There is insufficient evidence in the record to conclude that the trend will reverse.
87. The current gas cost for the City of Dallas is \$4.020.
88. It is reasonable to use the current gas costs in calculating the base rate.
89. TXU Gas Distribution provides transportation service to its affiliate, TXU LSP.
90. The cost of service for the Dallas Distribution System is allocated to all customers.
91. Based on findings of fact 89 & 90 it is not reasonable to credit any transportation revenues collected from TXU LSP to the cost of service of the Dallas Distribution System.
92. Transportation rates between TXU Gas Distribution and TXU LSP were not set in GUD No. 8976.
93. Labor expense declined after the close of the test year and some of the labor costs were shifted to supplies and expenses.
94. The use of an out of the test year adjustment factor to reflect a decreasing trend in the costs of labor is not reasonable in this case.
95. TXU Gas Distribution allocates labor fringe benefits to the Dallas Distribution System on the basis of total number of customers.

96. TXU Gas Distribution reasonably allocated the labor expenses of TXU Gas Distribution to the Dallas Distribution System.
97. The Railroad Commission of Texas has only approved the use of ELG methodology for calculating depreciation rates for a transmission utility.
98. The ELG methodology has a greater impact on rates when there is substantial new investment.
99. TXU Gas Distribution has made substantial new investments in the Dallas Distribution System since 1994.
100. It is reasonable to retain the ALG methodology currently in place for the Dallas Distribution System.
101. A 70-year average service life for Account 376.3, Mains-Plastic, is reasonable and should be adopted.
102. A 45-year average service life for Account 376.4, Mains-Valves, is reasonable and should be adopted.
103. A 70-year average service life for Account 376.5, Main-Steel Mill Wrapped/Bare, is reasonable and should be adopted.
104. A 38-year average service life for Account 380, Services, is reasonable and should be adopted.
105. A 5-year average service life for Account 398, Computers, is reasonable and should be adopted.
106. A 30% net salvage for the distribution function is reasonable and should be adopted.
107. A depreciation expense allocated to residential and commercial customers of \$4,638,353 is reasonable.
108. An adjustment for clearing accounts is not reasonable because TXU Gas Distribution stated that the accounts at issue were not clearing accounts during the test year.
109. A retroactive adjustment to depreciation is not reasonable because TXU Gas Distribution's treatment of fully accrued accounts is appropriate.
110. A five percent medical trend used in the calculation of the SFAS-106 expense is reasonable.
111. TXU Gas Distribution's decision not to establish an external fund is unreasonable.

112. It is reasonable to establish an external fund for SFAS-106.
113. TXU Gas Distribution has demonstrated that its affiliate expenditures are reasonable and necessary.
114. TXU Gas Distribution has demonstrated that the price charged by affiliates to TXU Gas Distribution is not higher than the prices charged to other affiliates or to non-affiliated persons.
115. Merger related expenses in the amount of \$584,664 and Y2K expenses in the amount of \$63,386 should be disallowed. TXU Gas Distribution has not established that Y2K expenses and merger related expenses are recurring.

Revenue Requirement

116. TXU Gas Distribution requested a total revenue requirement for the residential and commercial customers in the Dallas Distribution System in the amount of \$144,968,857, exclusive of service charges revenues.
117. The proposed total revenue requirement for the residential and commercial customers in the Dallas Distribution System is \$138,171,376, exclusive of service charges revenues.
118. The total revenue requirement proposed by TXU Gas Distribution includes revenue-related taxes of \$8,632,895. These revenue-related taxes are not included in the base rate.
119. The proposed total revenue requirement includes revenue-related taxes of \$8,228,100. These revenue-related taxes are not included in the base rate.
120. TXU Gas Distribution requested revenues for service charges to residential and commercial customers in the amount of \$1,463,896.
121. The service charges proposed by TXU Gas Distribution are reasonable.
122. Residential rates consisting of a customer charge of \$7.50, a volumetric charge per Mcf of \$3.3544, and an off peak discount of \$0.25 for each Mcf in excess of 8 Mcf for each of the billing months of May through October are reasonable.
123. Commercial rates consisting of a customer charge of \$13.50, and three different blocks of volumetric charges; \$3.5594 for the first 20 Mcf, \$3.2710 for the next 30 Mcf, and \$3.1267 for all consumption over 50 Mcf are reasonable.

Allocation of Total Plant

124. TXU Gas Distribution has not established that it is reasonable to divide the Dallas Distribution System for cost allocation purposes.

125. TXU Gas Distribution established that the cost of installing the minimum system required to serve all customers would cost \$11,742,983.
126. An allocation factor for customer-related costs based on total number of customers is reasonable.
127. An allocation factor for demand-related costs based exclusively on peak demand usage is not reasonable.
128. Residential and Commercial customers account for only 41.22% of total annual throughput.
129. An allocation factor that averages peak demand use with annual throughput is reasonable.

Rate Case Expenses

130. TXU Gas Distribution's rate case expenses in the amount of \$1,537,937.40 are reasonable.
131. It is reasonable to disallow the City of Dallas's expenses for resisting discovery in the amount of \$10,000 for the following reasons.
 - a. Details requested regarding expert witnesses were within the requirements of the Texas Rules of Civil Procedure.
 - b. Failing to make documents available for inspection as required by the procedural schedule.
132. The rate case expenses of the City of Dallas in the amount of \$721,869.04 are reasonable.

CONCLUSIONS OF LAW

1. TXU Gas Distribution is a gas utility as defined in the Texas Utilities Code (TUC). TEX. UTIL. CODE ANN. §§ 101.003(7) and 121.001 (Vernon Supp. 2000).
2. TXU Gas Distribution is subject to the jurisdiction of the Railroad Commission of Texas pursuant to the TUC. TEX. UTIL. CODE ANN. § 102.001. (Vernon 1998).
3. TXU Gas Distribution's filing and its public notice complied with the requirements of Section 104.102 and 104.103 of the TUC. TEX. UTIL. CODE ANN. §§ 104.102 & 104.103 (Vernon 1998).

4. TXU Gas Distribution failed to meet its burden of proof on the elements of its requested rate increase identified in this order. TEX. UTIL. CODE ANN. § 104.008 (Vernon 1998).
5. Under the TUC, payments to affiliates are excluded from TXU Gas Distribution's rate base or operating expenses unless the Railroad Commission of Texas specifically finds each item or class of items reasonable and necessary and finds that the price to TXU Gas Distribution is not higher than the prices charged by the supplying affiliate to its other affiliates or division or to a nonaffiliated person for the same item or class of items. TEX. UTIL. CODE ANN. § 104.055(b) (Vernon 1998).

RAILROAD COMMISSION OF TEXAS

MICHAEL L. WILLIAMS
CHAIRMAN

TONY GARZA
COMMISSISONER

CHARLES R. MATTHEWS
COMMISSIONER

ATTEST:

SECRETARY